

**JSC “REGIONALA
INVESTICIJU BANKA”**

**ANNUAL REPORT FOR THE YEAR
ENDED 31 DECEMBER 2009**



INVESTĪCIJU BANKA
A/S REĢIONĀLĀ INVESTĪCIJU BANKA

**JSC “REGIONALA INVESTICIJU BANKA”
ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2009**

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JSC Regionala Investiciju banka

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Report of the Management

Year 2009 was a year of development and continuation of previously commenced projects for JSC „Regionala investiciju banka” (hereinafter – the Bank). Bank has been strategically cautious in undertaking significant investments and new ambitious plans. In 2009 Bank has created provisions based on prudent evaluation of loan portfolio. Despite these provisions financial result for 2009 is small but positive: profit of LVL 53,553.

Overall economical situation

Along with changes caused by the economic and financial crisis since 2008, among other things, financial markets have experienced material changes in the form of diminishing financial assets and increasing financing costs.

During 2009 key risk for banking sector in Latvia still was liquidity risk, however, the significance of credit risks has increased considerably. Sharp decline in global and domestic economy led to further decline in purchasing ability of businesses and private individuals, increase in unemployment and decline in income. Ability of borrowers to fulfil their obligations on a timely basis deteriorated together with down grading of quality of loan portfolios in banking sector. As a result of declining quality of bank assets, amount of provisions for bad debts has increased significantly together with increase in operating losses in banking industry. This resulted in banks applying more conservative credit policies and declining amounts of new borrowings provided to both legal and private persons, thus backing off recovery of economy. Some of largest and previously heavily crediting banks in Latvia decided to decrease their loan portfolio significantly, thus causing lasting effect on Latvian economy.

Due to macro economical risks Latvian credit rating (long term liabilities in foreign currency) has declined. Based on evaluations of international credit rating agencies Fitch and Standard&Poor's it is below level required for investments. This downgrade leads not only to decrease in ability of Latvian government to borrow from the capital market but also has a significant negative effect on private sector, thus reinforcing economy decline and making the country unattractive for most investors.

The Bank is exposed to tendencies in Ukrainian market. Ukraine continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible outside of Ukraine, restrictive currency controls, and high inflation.

Key prerequisites for further development of Ukrainian economy are recovery of Ukrainian banking sector, tied with political and macro economical stability, as well as stabilisation of currency exchange rate.

Operations of the Bank are affected by tendencies in Bulgarian market where Bank has opened its branch as well. In 2009 Bulgaria continued to experience impact of financial crisis: external and internal demand for goods and services declined significantly negatively affecting all sectors of national economy and especially production.

Situation in Bulgarian financial markets has improved, with improved liquidity and decreased interbank interest rates; however, deposit and loan interest rates have remained high being an indication of economical instability.

Management believes it is taking all the necessary measures to support sustainable growth of the Bank's business in the present circumstances.

Performance of the Bank during the reporting year

Despite effect of the global financial crisis, the Bank has increased the number of clients with no significant decline in Client activity. Number of Clients has increased by almost 23% as compared to 2008.

In short period of time the Bank has managed to gain trust of its Clients and built large Clients' financial instruments portfolio, with market value amounting to 30.2 million lats as at 31 December 2009.

In comparison with the previous year, deposit portfolio have increased by 23.5% or by 20.1 million LVL, assets of the bank have increased by 16% or 17.8 million LVL, whereas loan portfolio have increased by 6.2% or 4 million LVL. Key financial indicators are showing that overall situation of the Bank is stable and the Bank is continuing its moderate growth process.

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In 2009 the Bank has updated its organisational structure creating two new structural units – Security department and Financial projects department and hired 7 new employees. Corporate client department has commenced active operations within the Bank, enhancing service quality of the Bank's corporate clients and paying specific attention to thorough analysis of Client business, search for the best offer and provision of valuable advice.

During the year significant improvements were made, as well as new systems and programmes were introduced to support Bank information technologies. This resulted not only in significant improvement of quality of data security of the Bank and its Clients, but also increased speed and convenience of electronic services. The Bank has developed a new IT module server room complying with all highest standards, thus improving safety of data storage.

In the beginning of the year to make services more convenient to its Clients, the Bank has opened new and modern Client service hall on the first floor of Bank building in Riga. In the beginning of 2009 new representative office was opened in Kiev, thus increasing network of representative offices in Ukraine. In October 2009 the Bank has opened its first branch Bulgarian town Varna. In Bulgaria the Bank is willing to establish corporate relationships with companies operating in transit and tourism business, making special emphasis on port business and ship building. In private person sector cooperation is expected with Bulgarians living in the south part of Ukraine and having business relationships in Bulgarian trade, logistic and tourism businesses.

In July the Bank became a full-fledged member of international payment card organisation “MasterCard Worldwide” thus improving overall security and independence status of the Bank.

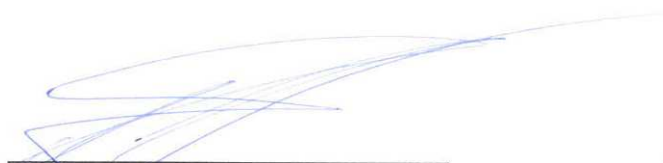
In September the Bank pleased its Clients with a new and modern service – SMS bank, allowing the Clients to control cash flow and current situation in accounts via mobile phone.

Future plans and perspectives

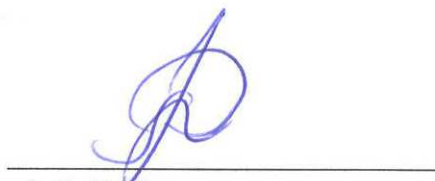
During the year 2010 the Bank plans to continue development of operations in its Bulgarian branch, improving service offer and increasing number of Clients. During the first half of 2010 it is planned to develop a new web page of the Bank containing information about the Bank and its branch in Bulgarian.

In order to enhance Client investment portfolios related services, Bank is planning to become a member of NASDAQ OMX Baltic financial instruments market at the beginning of the year.

Without decreasing headcount, in 2010 Bank is planning to carry out minor changes in organisational structure. Bank will continue with the project commenced in 2009 on purchase of new Bank premises or building, as well as continue actively attracting new Clients in both Latvian and Ukrainian markets.



Haralds Āboliņš
Chairman of the Board, President



Jurijs Rodins
Chairman of the Council

Riga, 12 March 2010

JSC "REGIONALA INVESTICIJU BANKA"
ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2009
THE SUPERVISORY COUNCIL AND THE BOARD OF DIRECTORS OF THE BANK

As at 31 December 2009 and as at the date of signing the accounts:

		Date of appointment
The Council		
Jurijs Rodins	Chairman of the Council	Re-elected – 31.08.2009
Marks Bekkers	Deputy Chairman of the Council	Re-elected – 31.08.2009
Dmitrijs Bekkers	Member of the Council	Re-elected – 31.08.2009
Vadims Morohovskis	Member of the Council	Re-elected – 31.08.2009
Arkādijs Fjodorovs	Member of the Council	Re-elected – 31.08.2009
Alla Vanecjancs	Member of the Council	Re-elected – 31.08.2009
The Board		
Haralds Āboliņš	Chairman of the Board and President	Re-elected – 31.08.2009
Oleksandr Kuperman	Member of the Board	Re-elected – 31.08.2009
Daiga Muravska	Member of the Board	Re-elected – 31.08.2009

JSC "REGIONALA INVESTICIJU BANKA"
ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2009


STATEMENT OF RESPONSIBILITY OF THE MANAGEMENT

The Supervisory Council and the Board of Directors (hereinafter - the Management) of the Bank are responsible for the preparation of the financial statements of the Bank.


The financial statements on pages 8 to 55 are prepared in accordance with the source documents and present fairly the financial position of the Bank as at 31 December 2009 and the results of its operations and cash flows for the reporting year 2009.

The financial statements are prepared in accordance with International Financial Reporting Standards as adopted in the European Union on a going concern basis. Appropriate accounting policies have been applied on a consistent basis. Prudent and reasonable judgements and estimates have been made by the Management in the preparation of the financial statements.

The Management of the Bank is responsible for the maintenance of proper accounting records, the safeguarding of the Bank's assets and the prevention and detection of fraud and other irregularities in the Bank. They are also responsible for operating the Bank in compliance with the Law on Credit Institutions, regulations of the Financial and Capital Market Commission, Bank of Latvia and other legislation of the Republic of Latvia applicable for credit institutions.



Haralds Āboliņš
Chairman of the Board, President



Jurijs Rodins
Chairman of the Council

Riga, 12 March 2010

**JSC "REGIONĀLA INVESTĪCIJU BANKA"
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Auditors' report



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INDEPENDENT AUDITORS' REPORT

To the Shareholders of AS Reģionālā Investīciju Banka

Report on the Financial Statements

We have audited the accompanying financial statements on pages 8 to 55 of AS Reģionālā Investīciju Banka which comprise the statement of financial position as of 31 December 2009 and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the European Union. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the accompanying financial statements give a true and fair view of the financial position of AS Reģionālā Investīciju Banka as of 31 December 2009, and of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the European Union.

Report on Other Legal and Regulatory Requirements

We have read the Management Report set out on pages 3 – 4 and did not identify material inconsistencies between the financial information contained in the Management Report and that contained in the financial statements for 2009.

Ahmed Abu Sharkh
Chairman of the Board

PricewaterhouseCoopers SIA
Certified audit company licence No. 5

Ilandra Lejiņa
Certified auditor in charge
Certificate No. 168

Rīga, Latvia
12 March 2010


* This version of our report is a translation from the original, which was prepared in Latvian. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

**JSC "REGIONALA INVESTICIJU BANKA"
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Statement of Comprehensive Income for the year ended 31 December 2009

	Notes	2009 LVL	2008 LVL
Interest income	5	9,085,135	7,948,993
Interest expense	5	<u>(5,258,470)</u>	<u>(3,392,738)</u>
Net interest income		3,826,665	4,556,255
Provisions for loan impairment	11	<u>(2,262,846)</u>	<u>(594,906)</u>
Net interest income after provision for loan impairment		1,563,819	3,961,349
Fee and commission income	6	2,252,725	2,011,020
Fee and commission expense	6	<u>(590,128)</u>	<u>(523,580)</u>
Net fee and commission income	6	1,662,597	1,487,440
Profit/ (Loss) on securities trading, net		(67,693)	18,017
Profit/ (Loss) from revaluation of securities at fair value through profit and loss account, net		393,387	(1,131,460)
Profit/ (Loss) on derivative financial instruments revaluation, net		(142,369)	163,935
Profit on operation with foreign exchange, net		444,099	482,788
Profit/ (Loss) from revaluation of foreign exchange, net		158,828	(122,699)
Other operating income		13,954	47,868
Administrative expense	7	(3,390,585)	(3,329,117)
Amortisation and depreciation charge	13, 14	(264,668)	(161,165)
Other operating expense		<u>(55,679)</u>	<u>(61,421)</u>
Profit before income tax		315,690	1,355,535
Income tax expense	8	-	(382,559)
Amount of tax paid abroad	8	(257,267)	-
Deferred income tax	8	(4,870)	880
Net profit for the year		53,553	973,856
Total comprehensive income for the year attributable to the shareholders of the Bank		53,553	973,856

The financial statements on pages 8 to 55 have been approved by the Supervisory Council and the Board of Directors of the Bank and signed on their behalf by:



Haralds Āboliņš
Chairman of the Board, President



Jurijs Rodins
Chairman of the Council


Riga, 12 March 2010

The accompanying notes on pages 12 to 55 are an integral part of these financial statements.

JSC "REGIONALA INVESTICIJU BANKA"
ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2009
Statement of Financial Position as at 31 December 2009

	Notes	31.12.2009 LVL	31.12.2008 LVL
Assets			
Cash and balances with the Bank of Latvia	9	6,665,204	5,897,042
Balances due from banks	10	40,265,263	34,005,094
Loans and advances to customers	11	67,618,082	65,252,570
Financial assets at fair value through profit or loss	12	10,138,920	4,201,311
Derivative financial instruments	20	31,768	273,279
Intangible assets	13	461,740	414,809
Property and equipment	14	478,310	593,469
Other assets		202,892	561,186
Deferred expenses		98,539	64,946
Corporate income tax	30	300,846	172
Total assets		126,261,564	111,263,878
Liabilities			
Balances due to banks	16	1,682,288	7,895,233
Due to customers	15	109,233,485	88,140,326
Derivative financial instruments	20	43,501	142,643
Other financial liabilities	17	265,427	211,821
Deferred income and accrued expenses	18	503,558	398,973
Deferred income tax liability	19	12,769	7,899
Total liabilities		111,741,028	96,796,895
Equity			
Share capital	21	10,200,000	10,200,000
Retained earnings		4,266,983	3,293,127
Comprehensive income for the year		53,553	973,856
Total equity		14,520,536	14,466,983
Total liabilities and equity		126,261,564	111,263,878
Commitments and contingent liabilities			
Contingent liabilities	22	537,955	111,429
Financial commitments	22	6,619,777	11,690,481
Funds under trust management	22	-	120,155

The financial statements on pages 8 to 55 have been approved by the Supervisory Council and the Board of Directors of the Bank and signed on their behalf by:


 Haralds Āboliņš
 Chairman of the Board, President


 Jurijs Rodins
 Chairman of the Council

Riga, 12 March 2010

The accompanying notes on pages 12 to 55 are an integral part of these financial statements.

JSC "REGIONALA INVESTICIJU BANKA"
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Statement of Changes in Equity for the year ended 31 December 2009

	Paid-in share capital LVL	Retained earnings LVL	Total LVL
Balance as at 31 December 2007	8,200,000	3,293,127	11,493,127
Comprehensive income for the year	-	973,856	973,856
Increase of share capital*	2,000,000	-	2,000,000
Balance as at 31 December 2008	10,200,000	4,266,983	14,466,983
Comprehensive income for the year	-	53,553	53,553
Balance as at 31 December 2009	10,200,000	4,320,536	14,520,536

* see Note 21.

The accompanying notes on pages 12 to 55 are an integral part of these financial statements.

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Statement of Cash Flows for the year ended 31 December 2009

	Notes	2009 LVL	2008 LVL
Cash flows from operating activities			
Interest received		7,805,855	7,331,894
Interest paid		(4,769,624)	(3,094,150)
Fees and commission received		2,252,725	2,011,020
Fees and commission paid		(590,128)	(523,580)
Income on securities trading		(67,693)	18,017
Income on foreign exchange		474,074	335,282
Other operating income		13,954	47,868
Personnel expenses paid		(1,817,501)	(1,854,348)
Administrative and other operating expenses paid		(1,628,112)	(1,536,191)
Income tax paid		(558,592)	(337,414)
		<u>1,114,958</u>	<u>2,398,398</u>
Cash flows from operating activities before changes in operating assets and liabilities			
		1,114,958	2,398,398
Changes in operating assets and liabilities			
Net (increase) / decrease of securities at fair value through profit and loss account		(5,441,369)	541,704
Net (increase) / decrease of balances due from banks		13,779,887	(16,006,734)
Net increase of loans and advances to customers		(3,287,798)	(16,951,960)
Net (increase) / decrease of other assets		324,701	(97,721)
Net increase of balances due to customers		20,604,313	36,150,206
Net increase in other liabilities		158,191	147,942
		<u>27,252,883</u>	<u>6,181,835</u>
Net cash and cash equivalents from operating activities			
		27,252,883	6,181,835
Cash flows from investing activities			
Purchase of intangible assets		(134,108)	(215,930)
Purchase of fixed assets		(62,332)	(410,450)
		<u>(196,440)</u>	<u>(626,380)</u>
Net cash and cash equivalents used in investing activities			
		(196,440)	(626,380)
Cash flows from financing activities			
Debt securities repaid		-	(2,850,438)
Issue of ordinary shares		-	2,000,000
		<u>-</u>	<u>(850,438)</u>
Net cash and cash equivalents used in financing activities			
		-	(850,438)
Effect of exchange rates on cash and cash equivalents		(158,828)	41,237
		<u>26,897,615</u>	<u>4,746,254</u>
Net increase in cash and cash equivalents			
		26,897,615	4,746,254
Cash and cash equivalents at the beginning of the year	23	<u>13,851,246</u>	<u>9,104,992</u>
Cash and cash equivalents at the end of the year	23	<u>40,748,861</u>	<u>13,851,246</u>

The accompanying notes on pages 12 to 55 are an integral part of these financial statements.

JSC "REGIONALA INVESTICIJU BANKA"
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NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 INCORPORATION AND PRINCIPAL ACTIVITIES

JSC "Reģionālā Investīciju banka" (hereinafter – the Bank) provides financial services to corporate clients and individuals. The Bank established its representative office in Odessa, Ukraine in 2005 and representative office in Dnepropetrovsk, Ukraine in 2007. In the beginning of 2009 the Bank has established new representative office in Kiev, Ukraine. During the year, the Bank also actively worked on establishment of the branch in Bulgaria and in October 2009 opened its first branch in Bulgarian town Varna. The Bank has no subsidiaries and branches apart from the mentioned above.

The Bank is a joint-stock company incorporated and domiciled in Riga, Republic of Latvia. It was registered within Commercial Register on 28 September 2001.

The legal and basic address of the Bank is:

J. Alunana Street 2,
LV-1010, Riga,
Latvia

These financial statements have been approved for issue by the Supervisory Council and the Board of Directors on 12 March 2010.

NOTE 2 OPERATING ENVIRONMENT OF THE BANK

Instability in the global and Latvian financial markets and economies

Along with changes caused by the economic and financial crisis since 2008, among other things, financial markets have experienced material changes in the form of diminishing financial assets and increasing financing costs, and uncertainty in the business and investment environment has increased. Changes in the global financial markets have caused banks and other financial institutions to go bankrupt, with bank rescues being undertaken in many countries including Latvia. Although the recovery trend is strengthening in the global economy, it is currently not possible to predict reliably when Latvia's economy will begin to grow again.

The Bank is exposed to tendencies in Ukrainian market. Ukraine continues to display certain characteristics of an emerging market. These characteristics include, but are not limited to, the existence of a currency that is not freely convertible outside of Ukraine, restrictive currency controls, and high inflation.

As a result of the global financial crisis, the Ukrainian economy experienced reduced level of capital inflow and decrease in demand for exports, as well as significant decline in GDP (by 14% in 2009), and increased pressure on the state budget. Additionally, the country ratings by international rating agencies were downgraded in 2009. These factors, together with increasing domestic political and economical uncertainty, led to volatility in the currency exchange market and resulted in significant downward pressure on the Ukrainian hryvnia relative to major foreign currencies. Simultaneously Ukrainian banking sector suffered from outflow of customer deposits, liquidity problems, decline in quality of assets, as well as bankruptcies and restructurings of banks. In 2010 due to recovery of global economy gradual increase in export is expected. Political situation in the country is expected to stabilise after elections.

Operations of the Bank are affected by tendencies in Bulgarian market where Bank has opened its branch as well. In 2009 Bulgaria continued to experience impact of financial crisis: external and internal demand for goods and services declined significantly negatively affecting all sectors of national economy and especially production. Expected increase in unemployment and limited income of inhabitants will lead to further decline in internal demand, however it is expected that external demand will cease to decline starting with beginning of 2010. Increase in external demand in Bulgaria is expected alongside with gradual recovery of economies of Bulgarian partner countries (European Union countries).

Management is unable to estimate reliably the possible effects on the Bank's financial position of any further instability in the economies and financial markets of Latvia and other countries in the region as well as the economic downturn in Latvia. Management believes it is taking all the necessary measures to support sustainable growth of the Bank's business in the present circumstances.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 2 OPERATING ENVIRONMENT OF THE BANK (continued)

Impact on liquidity:

The volume of interbank financing has significantly diminished since 2008. Such conditions may affect the Bank's ability to obtain new borrowings and to refinance its existing borrowings on terms similar to those applied to earlier transactions. Maturities of the loans repayable by the Bank are disclosed in Notes 26 and 27.

Impact on asset valuation:

Solvency of the Bank's customers may be affected by their reduced liquidity and ability to continue business operations during a prolonged economic downturn. Customers' deteriorating operating conditions may affect management's cash-flow forecasts and assessment of the impairment of financial and non-financial assets. Management's assumptions about recoverable amounts of the assets are based on the information available; however it is not possible to determine reliably the full impact of the economic downturn.

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A summary of the significant accounting policies, all of which have been applied consistently throughout the years 2008 and 2009, are set out below:

(a) Reporting currency

The tabular amounts in the accompanying financial statements are reported in Latvian lats (LVL), unless otherwise stated.

(b) Basis of preparation

These financial statements are prepared in accordance with International Financial Reporting Standards (hereinafter - IFRS) as adopted in the European Union, on a going concern basis. In preparation of the financial statements on a going concern basis the management considered the Bank's financial position, access to financial resources and analysed the impact of the recent financial crisis on the future operations of the Bank.

The financial statements are prepared under the historical cost convention as modified by the fair valuation of financial assets held at fair value through profit or loss and derivative financial instruments.

The preparation of financial statements in conformity with IFRS requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on Management's best knowledge of current events and actions, actual results ultimately may differ from those estimates.

The accounting policies used in the preparation of the financial statements for the year ended 31 December 2009 are consistent with those used in the annual financial statements for the year ended 31 December 2008, except as referred to in Note 3 (bb) *Adoption of New or Revised Standards and Interpretations*.

(c) Income and expense recognition

Interest income and expense are recognised in the statement of comprehensive income for all interest bearing instruments on an accrual basis using the effective interest method. Interest income includes coupons earned on trading securities.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

When loans become doubtful of collection, they are written down to their recoverable amounts and interest income is thereafter recognised based on the rate of interest that was used to discount the future cash flows for the purpose of measuring the recoverable amount.

JSC "REGIONALA INVESTICIJU BANKA"
ANNUAL REPORT FOR THE YEAR ENDED 31 DECEMBER 2009
NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Commissions received or incurred in respect of origination of financial assets or funding are deferred and recognised as an adjustment to the effective interest rate on the asset or liability. Other fees and commissions, including those related to trust activities, are credited and/or charged to the statement of comprehensive income as earned / incurred.

(d) Foreign currency translation

Functional and presentation currency

Items included in the financial statements of the Bank are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The financial statements are presented in 'Latvian lats' ('LVL'), which is the Bank's functional and presentation currency.

Transactions and balances

Transactions denominated in foreign currencies are recorded in lats at rates of exchange set forth by the Bank of Latvia at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into lats at the rate of exchange prevailing at the end of the period. Any gain or loss resulting from a change in rates of exchange subsequent to the date of the transaction is included in the statement of comprehensive income as a profit or loss from revaluation of foreign currency positions.

The principal rates of exchange (LVL to 1 foreign currency unit) set forth by the Bank of Latvia and used in the preparation of the Bank's balance sheets were as follows:

Reporting date	<u>USD</u>	<u>EUR</u>	<u>BGN</u>	<u>UAH</u>
As at 31 December 2009	0.489	0.702804	0.359	0.0610
As at 31 December 2008	0.495	0.702804	0.359	0.0656

(e) Income taxes

Income tax is calculated in accordance with Latvian tax regulations and is based on the taxable income reported for the taxation period.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. The deferred income tax is calculated based on currently enacted tax rates that are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. The principal temporary differences arise from different rates of accounting and tax amortisation and depreciation on intangible and fixed assets, as well as accruals for employee vacation expenses. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash and demand deposits with the Bank of Latvia and other credit institutions, due to and from other credit institutions with original maturity of 3 months or less.

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NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(g) Loans and provisions for loan impairment

Loans and advances to customers are accounted for as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in active markets.

Loans and receivables are recognised initially at fair value plus transaction costs that are directly attributable to the acquisition of financial asset. Loans and receivables are subsequently carried at amortised cost using the effective interest method. All loans and receivables are recognised when cash is advanced to borrowers and derecognised on repayments.

The Bank assesses at each balance sheet date whether there is objective evidence that loans and receivables are impaired. If any such evidence exists, the amount of the loss for loan impairment which has been incurred is measured as the difference between the asset's carrying amount and the recoverable amount, being the present value of expected cash flows (excluding future credit losses that have not been incurred), including amounts recoverable from guarantees and collateral, discounted at the original effective interest rate. The Bank does not perform collective assessment of provisions as it can carry out assessment of each individual loan taken the number of loans issued.

The primary factors that the Bank considers in determining whether a financial asset is impaired are its overdue status and realisability of related collateral, if any.

The following other principal criteria are also used to determine whether there is objective evidence that an impairment loss has occurred:

- any instalment is overdue and the late payment cannot be attributed to a delay caused by the settlement systems;
- the borrower experiences a significant financial difficulty as evidenced by the borrower's financial information that the Bank obtains;
- the borrower considers bankruptcy or a financial reorganisation;
- there is an adverse change in the payment status of the borrower as a result of changes in the national or local economic conditions that impact the borrower; or
- the value of collateral significantly decreases as a result of deteriorating market conditions.

The carrying amount of the asset is reduced through the use of a provision account and the amount of the loss is recognised in the statement of comprehensive income. The assessment of the evidence for impairment and the determination of the amount of provision for impairment or its reversal require the application of Management's judgment and estimates. Management's judgments and estimates consider relevant factors including, but not limited to, the identification of non-performing loans and high risk loans, the Bank's past loan loss experience, known and inherent risks in the portfolio of loans, adverse situations that affects the borrowers' ability to repay, the estimated value of any underlying collateral and current economic conditions as well as other relevant factors affecting loan and advance recoverability and collateral values. These judgments and estimates are reviewed periodically, and historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. The Management of the Bank has made their best estimates of losses, based on objective evidence of impairment and believes those estimates presented in the financial statements are reasonable in light of available information. Nevertheless, it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the asset or liability affected.

When loans and receivables cannot be recovered, they are written off and charged against provision for loan impairment losses. They are not written off until all the necessary legal procedures have been completed and the amount of the loss is finally determined.

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NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(h) Credit related commitments

The Bank enters into credit related commitments, including undrawn credit lines, letters of credit and financial guarantees. Financial guarantees represent irrevocable assurances to make payments in the event that a customer cannot meet its obligations to third parties and carry the same credit risk as loans. Financial guarantees and commitments to provide a loan are initially recognised at their fair value, which is normally evidenced by the amount of fees received. This amount is amortised on a straight line basis over the life of commitment, except for commitments to originate loans if it is probable that the Bank will enter into a specific lending arrangement and does not expect to sell the resulting loan shortly after the origination; such loan commitment fees are deferred and included in the carrying value of the loan on initial recognition. At each balance sheet date, the commitments are measured at the higher of (i) the remaining unamortised balance of the amount at initial recognition and (ii) the best estimate of expenditure required to settle the commitment at the balance sheet date.

(i) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading and those designated at fair value through profit or loss at inception. The Bank does not designate any financial assets as at fair value through profit or loss at inception. Financial assets at fair value through profit or loss comprise debt securities held by the Bank for trading purposes. They are accounted for at fair value with all gains and losses from revaluation and trading reported in the statement of comprehensive income. Interest earned while holding trading securities is reported as interest income.

All regular way purchases and sales of financial assets held for trading are recognised at trade date, which is the date that the Bank commits to purchase or sell the asset.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

(j) Sale and repurchase agreements of securities

Sale and repurchase agreements are accounted for as financing transactions. Under sale and repurchase agreements, where the Bank is a transferor, assets transferred remain on the Bank's balance sheets and are subject to the Bank's usual accounting policies, with the purchase price received included as a liability owed to the transferee.

Where the Bank is a transferee, the assets are not included in the Bank's balance sheet, but the purchase price paid by it to the transferor is included as an asset. Interest income or expense arising from outstanding sale and repurchase agreements is recognised in the statement of comprehensive income over the term of the agreement using the effective interest method.

(k) Derivative financial instruments

Derivative financial instruments include foreign exchange contracts, currency and interest rate swaps held by the Bank for trading purposes. Derivative financial instruments are recognised on trade date and categorised as financial assets at fair value through profit or loss. They are initially recognised in the balance sheet at fair value and subsequently measured at their fair value with all gains and losses from revaluation reported in the statement of comprehensive income. All derivatives are carried as financial assets when fair value is positive and as financial liabilities when fair value is negative.

(l) Due from other banks

Amounts due from other banks are recorded when the Bank advances money to counterparty banks with no intention of trading the resulting unquoted non-derivative receivable due on fixed or determinable dates. Amounts due from other banks are carried at amortised cost.

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NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(m) Fair values of financial assets and liabilities

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values of financial assets or liabilities, including derivative financial instruments, in active markets are based on quoted market prices. If the market for a financial asset or liability is not active (and for unlisted securities), the Bank establishes fair value by using valuation techniques. These include the use of discounted cash flow analysis, option pricing models and recent comparative transactions as appropriate, and may require the application of management's judgment and estimates.

Where, in the opinion of the Management, the fair values of financial assets and liabilities differ materially from their book values, such fair values are separately disclosed in the notes to the accounts.

(n) Derecognition of financial assets

The Bank derecognises financial assets when (i) the assets are redeemed or the rights to cash flows from the assets otherwise expired or (ii) the Bank has transferred substantially all the risks and rewards of ownership of the assets or (iii) the Bank has neither transferred nor retained substantially all risks and rewards of ownership but has not retained control. Control is retained if the counterparty does not have the practical ability to sell the asset in its entirety to an unrelated third party without needing to impose additional restrictions on the sale.

(o) Intangible assets

Acquired computer software licences are recognised as intangible assets on the basis of the costs incurred to acquire and bring to use the software. These costs are amortised on the basis of their expected useful lives, not exceeding five years.

(p) Property and Equipment

All property and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Bank and the cost of the item can be measured reliably. All other repairs and maintenance are charged to the statement of comprehensive income during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate cost of the fixed assets to their residual values over their estimated useful lives, as follows:

Office equipment	10 years
Computers	3 years
Transport	5 years

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Leasehold improvements are capitalised and depreciated over their expected useful lives, or over the remaining lease contract period if shorter, on a straight-line basis.

Property and equipment are periodically reviewed for impairment. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains or losses on disposals are determined by comparing carrying amount with proceeds and are charged to the statement of comprehensive income in the period in which they are incurred.

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NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(q) Operating lease – the Bank is a lessee

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any financial incentives received from the lessor) are charged to the statement of comprehensive income on a straight-line basis over the period of the lease.

(r) Customer accounts

Customer accounts are non-derivative liabilities to individuals, state or corporate customers and are carried at amortised cost.

(s) Borrowings

Borrowings are recognised initially at fair value net of transaction costs incurred. Borrowings are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the statement of comprehensive income over the period of the borrowings using the effective interest method.

(t) Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made. The assessment of provisions requires the application of management's judgment and estimates, as to the probability of an outflow of resources, the probability of recovery of resources from corresponding sources including security or collateral or insurance arrangements where appropriate, and the amounts and timings of such outflows and recoveries, if any.

(u) Dividends

Dividends are recorded in equity in the period in which they are declared. Dividends declared after the balance sheet date and before the financial statements are authorised for issue are disclosed in the subsequent events note. The statutory accounting reports of the Bank are the basis for profit distribution and other appropriations. Latvian legislation identifies the basis of distribution as retained earnings.

(v) Employee benefits

The Bank pays State compulsory social security contributions for state pension insurance and to the state funded pension scheme in accordance with Latvian legislation. State funded pension scheme is a defined contribution plan under which the Bank pays fixed contributions determined by the law and it will have no legal or constructive obligations to pay further contributions if the state pension insurance system or state funded pension scheme are not able to settle their liabilities to employees.

Short-term employee benefits, including salaries and state compulsory social security contributions, bonuses and paid vacation benefits, are included in Administrative expenses on an accrual basis.

(w) Off-balance sheet instruments

In the ordinary course of business, the Bank utilises off-balance sheet financial instruments including commitments to extend loans and advances, financial guarantees and commercial letters of credit. Such financial instruments are recorded in the financial statements when they are funded or related fees are incurred or received. The methodology for provisioning against off-balance sheet instruments is given in paragraph (t) of Note 3 above.

(x) Trust operations

Funds managed or held in custody by the Bank on behalf of individuals, trusts and other institutions are not regarded as assets of the Bank and, therefore, are not included in the balance sheet.

Accounting for trust operations is separated from the Bank's own accounting system thus ensuring separate accounting in a separate trust balance sheet for assets of each client, by client and by type of assets under management.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(y) Debt securities in issue

Debt securities in issue include bonds issued by the Bank. Debt securities are stated at amortised cost. If the Bank purchases its own debt securities in issue, they are removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid is included in gains arising from retirement of debt.

(z) Offsetting of Financial Assets and Liabilities

Financial assets and liabilities are offset and net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

(aa) Critical accounting estimates

Loan impairment

The Bank reviews its loan portfolio to assess impairment on a regular basis. In determining whether an impairment loss should be recorded in the statement of comprehensive income, the Bank's Management makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio.

This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

The Bank applies stress – tests in order to evaluate the impact of changes in one or a number of variables, which are used for determination of provisions for loan impairment losses, on the financial result. If overdue loans in loan portfolio increase by 1%, provisions for loan impairment losses would increase by LVL 287.3 thousand.

Securities valued at fair value.

The Bank used quoted market prices to value securities carried at fair value as at year end for those securities which in the management's judgement are traded at liquid markets. The management had evaluated the liquidity of the securities market and has concluded that there is a significant reduction of activities in market, however, consider the market to be active with respect to type of securities held by the Bank therefore quoted market prices available on Stock Exchange of the security issuer countries were used to determine the fair values of the securities as at year end.

Initial recognition of related party transactions

In the normal course of business the Bank enters into transactions with its related parties. IAS 39 requires initial recognition of financial instruments based on their fair values. Management's judgement is applied in determining if transactions are priced at market or non-market interest rates, where there is no active market for such transactions. The basis for judgement is pricing for similar types of transactions with unrelated parties and effective interest rate analysis.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(bb) Adoption of new or revised standards and interpretations

Certain new IFRSs became effective for the Bank from 1 January 2009. Listed below are those new or amended standards or interpretations which are relevant to the Bank’s operations and the nature of their impact on the Bank’s accounting policies.

IAS 1, Presentation of Financial Statements, revised in September 2007. The main change in IAS 1 is the replacement of the income statement by a statement of comprehensive income which includes all non-owner changes in equity, such as the revaluation of available-for-sale financial assets. Alternatively, entities are allowed to present two statements: a separate income statement and a statement of comprehensive income. The Group has elected to present a single statement of comprehensive income. The revised IAS 1 also introduces a requirement to present a statement of financial position (balance sheet) at the beginning of the earliest comparative period whenever the entity restates comparatives due to reclassifications, changes in accounting policies, or corrections of errors. The revised IAS 1 had an impact on the presentation of the Group’s financial statements but had no impact on the recognition or measurement of specific transactions and balances.

Improving Disclosures about Financial Instruments - Amendment to IFRS 7, Financial Instruments: Disclosures, issued in March 2009. The amendment requires enhanced disclosures about fair value measurements and liquidity risk. The entity is required to disclose an analysis of financial instruments using a three-level fair value measurement hierarchy. The amendment (a) clarifies that the maturity analysis of liabilities should include issued financial guarantee contracts at the maximum amount of the guarantee in the earliest period in which the guarantee could be called; and (b) requires disclosure of remaining contractual maturities of financial derivatives if the contractual maturities are essential for an understanding of the timing of the cash flows. An entity will further have to disclose a maturity analysis of financial assets it holds for managing liquidity risk, if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk. The enhanced disclosures are included in these financial statements.

Certain new IFRSs became effective for the Bank from 1 January 2009. Listed below are those new or amended standards or interpretations which are not relevant to the Bank’s operations and policies.

IAS 23, Borrowing Costs, revised in March 2007. The main change is the removal of the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. Borrowing costs that are directly attributable to the acquisition, construction or production of an asset that [is not carried at fair value and that] necessarily takes a substantial period of time to get ready for its intended use or sale (a qualifying asset) form part of the cost of that asset, if the commencement date for capitalisation is on or after 1 January 2009. Other borrowing costs are recognised as an expense using the effective interest method. The amendment did not have an impact on these financial statements.

Puttable Financial Instruments and Obligations Arising on Liquidation—IAS 32 and IAS 1 Amendment. The amendment requires classification as equity of some financial instruments that meet the definition of financial liabilities. The amendment did not have an impact on these financial statements.

Vesting Conditions and Cancellations—Amendment to IFRS 2, Share-based Payment. The amendment clarified that only service conditions and performance conditions are vesting conditions. Other features of a share-based payment are not vesting conditions. The amendment specifies that all cancellations, whether by the entity or by other parties, should receive the same accounting treatment. The amendment did not have an impact on these financial statements.

IFRS 8, Operating Segments. The standard applies to entities whose debt or equity instruments are traded in a public market or that file, or are in the process of filing, their financial statements with a regulatory organisation for the purpose of issuing any class of instruments in a public market. IFRS 8 requires an entity to report financial and descriptive information about its operating segments, with segment information presented on a similar basis to that used for internal reporting purposes. The amendment did not have an impact on these financial statements.

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NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(bb) Adoption of new or revised standards and interpretations (continued)

IFRIC 13, Customer Loyalty Programmes. IFRIC 13 clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement using fair values. The amendment did not have an impact on these financial statements.

IFRIC 14, ‘IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction’ (effective for annual periods beginning on or after 1 January 2008). This interpretation provides guidance on assessing the limit in IAS 19, ‘Employee benefits’, on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. This interpretation did not have any material impact on these financial statements.

Embedded Derivatives - Amendments to IFRIC 9 and IAS 39, issued in March 2009. The amendments clarify that on reclassification of a financial asset out of the ‘at fair value through profit or loss’ category, all embedded derivatives have to be assessed and, if necessary, separately accounted for. The amendment did not have an impact on these financial statements.

IFRIC 15, Agreements for the Construction of Real Estate. The interpretation applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors, and provides guidance for determining whether agreements for the construction of real estate are within the scope of IAS 11 or IAS 18. It also provides criteria for determining when entities should recognise revenue on such transactions. The amendment did not have any material impact on these financial statements.

IFRIC 16, Hedges of a Net Investment in a Foreign Operation. The interpretation explains which currency risk exposures are eligible for hedge accounting and states that translation from the functional currency to the presentation currency does not create an exposure to which hedge accounting could be applied. The IFRIC allows the hedging instrument to be held by any entity or entities within a group except the foreign operation that itself is being hedged. The interpretation also clarifies how the currency translation gain or loss reclassified from other comprehensive income to profit or loss is calculated on disposal of the hedged foreign operation. Reporting entities apply IAS 39 to discontinue hedge accounting prospectively when their hedges do not meet the criteria for hedge accounting in IFRIC 16. IFRIC 16 did not have an impact on these financial statements.

Improvements to International Financial Reporting Standards (issued in May 2008). In 2008, the International Accounting Standards Board decided to initiate an annual improvements project as a method of making necessary, but non-urgent, amendments to IFRS. The amendments consist of a mixture of substantive changes, clarifications, and changes in terminology in various standards. The substantive changes relate to the following areas: classification as held for sale under IFRS 5 in case of a loss of control over a subsidiary; possibility of presentation of financial instruments held for trading as non-current under IAS 1; accounting for sale of IAS 16 assets which were previously held for rental and classification of the related cash flows under IAS 7 as cash flows from operating activities; clarification of definition of a curtailment under IAS 19; accounting for below market interest rate government loans in accordance with IAS 20; making the definition of borrowing costs in IAS 23 consistent with the effective interest method; clarification of accounting for subsidiaries held for sale under IAS 27 and IFRS 5; reduction in the disclosure requirements relating to associates and joint ventures under IAS 28 and IAS 31; enhancement of disclosures required by IAS 36; clarification of accounting for advertising costs under IAS 38; amending the definition of the fair value through profit or loss category to be consistent with hedge accounting under IAS 39; introduction of accounting for investment properties under construction in accordance with IAS 40; and reduction in restrictions over manner of determining fair value of biological assets under IAS 41. Further amendments made to IAS 8, 10, 18, 20, 29, 34, 40, 41 and to IFRS 7 represent terminology or editorial changes only, which the IASB believes have no or minimal effect on accounting. The amendments did not have an impact on the policies of the Bank.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(bb) Adoption of new or revised standards and interpretations (continued)

Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 July 2009 or later periods and which are not early adopted by the Bank.

IAS 27, Consolidated and Separate Financial Statements (revised January 2008; effective for annual periods beginning on or after 1 July 2009). The revised IAS 27 will require an entity to attribute total comprehensive income to the owners of the parent and to the non-controlling interests (previously “minority interests”) even if this results in the non-controlling interests having a deficit balance (the current standard requires the excess losses to be allocated to the owners of the parent in most cases). The revised standard specifies that changes in a parent’s ownership interest in a subsidiary that do not result in the loss of control must be accounted for as equity transactions. It also specifies how an entity should measure any gain or loss arising on the loss of control of a subsidiary. At the date when control is lost, any investment retained in the former subsidiary will have to be measured at its fair value. The amendment did not have an impact on these financial statements.

Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate—IFRS 1 and IAS 27 Amendment, issued in May 2008. The amendment allows first-time adopters of IFRS to measure investments in subsidiaries, jointly controlled entities or associates at fair value or at previous GAAP carrying value as deemed cost in the separate financial statements. The amendment also requires distributions from pre-acquisition net assets of investees to be recognised in profit or loss for the year rather than as a recovery of the investment. The amendment did not have an impact on these financial statements.

Eligible Hedged Items—Amendment to IAS 39, Financial Instruments: Recognition and Measurement (effective with retrospective application for annual periods beginning on or after 1 July 2009). The amendment clarifies how the principles that determine whether a hedged risk or portion of cash flows is eligible for designation should be applied in particular situations. The amendment is not expected to have any impact on the Group’s financial statements as the Group does not apply hedge accounting.

IFRS 1, First-time Adoption of International Financial Reporting Standards (following an amendment in December 2008, effective for the first IFRS financial statements for a period beginning on or after 1 July 2009). The revised IFRS 1 retains the substance of its previous version but within a changed structure in order to make it easier for the reader to understand and to better accommodate future changes. The Bank concluded that the revised standard does not have any effect on its financial statements.

IFRIC 12, ‘Service concession arrangements’ (effective for annual periods beginning on or after 1 January 2008. Effective for annual periods beginning on or after 30 March 2009 for companies that prepare financial statements based on the IFRS as adopted by the EU.). This interpretation applies to contractual arrangements whereby a private sector operator participates in the development financing, operation and maintenance of infrastructure for public sector services, for example, under private finance initiative contracts (PFI) contracts. Under these arrangements, assets are assessed as either intangible assets or finance receivables. The Bank does not expect that the interpretation will have a material impact on its financial statements.

IFRIC 17, Distributions of Non-Cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies when and how distribution of non-cash assets as dividends to the owners should be recognised. An entity should measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed. A gain or loss on disposal of the distributed non-cash assets will be recognised in profit or loss for the year when the entity settles the dividend payable. IFRIC 17 is not relevant to the Group’s operations because it does not distribute non-cash assets to owners.

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NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(bb) Adoption of new or revised standards and interpretations (continued)

IFRIC 18, Transfers of Assets from Customers (effective for annual periods beginning on or after 1 July 2009). The interpretation clarifies the accounting for transfers of assets from customers, namely, the circumstances in which the definition of an asset is met; the recognition of the asset and the measurement of its cost on initial recognition; the identification of the separately identifiable services (one or more services in exchange for the transferred asset); the recognition of revenue, and the accounting for transfers of cash from customers. IFRIC 18 is not expected to have any impact on the Group's financial statements.

Certain new standards and interpretations have been published that become effective for the accounting periods beginning on or after 1 January 2010 or later periods and which have not been endorsed by the EU:

IFRS 3, Business Combinations (revised January 2008; effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009). The revised IFRS 3 will allow entities to choose to measure non-controlling interests using the existing IFRS 3 method (proportionate share of the acquiree's identifiable net assets) or at fair value. The revised IFRS 3 is more detailed in providing guidance on the application of the purchase method to business combinations. The requirement to measure at fair value every asset and liability at each step in a step acquisition for the purposes of calculating a portion of goodwill has been removed. Instead, in a business combination achieved in stages, the acquirer will have to remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss for the year. The revised IFRS 3 brings into its scope business combinations involving only mutual entities and business combinations achieved by contract alone. IFRS 3 is not relevant to the Bank as it does not expect a business combination to occur.

Amendment to IAS 24, Related Party Disclosures (issued in November 2009 and effective for annual periods beginning on or after 1 January 2011). IAS 24 was revised in 2009 by: (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies; and by (b) providing a partial exemption from the disclosure requirements for government-related entities.

Classification of Rights Issues - Amendment to IAS 32 (issued 8 October 2009; effective for annual periods beginning on or after 1 February 2010). The amendment exempts certain rights issues of shares with proceeds denominated in foreign currencies from classification as financial derivatives.

Additional Exemptions for First-time Adopters - Amendments to IFRS 1, First-time Adoption of IFRS (effective for annual periods beginning on or after 1 January 2010). The amendments exempt entities using the full cost method from retrospective application of IFRSs for oil and gas assets and also exempt entities with existing leasing contracts from reassessing the classification of those contracts in accordance with IFRIC 4, 'Determining Whether an Arrangement Contains a Lease' when the application of their national accounting requirements produced the same result. The amendments will not have any impact on the financial statements.

Group Cash-settled Share-based Payment Transactions - Amendments to IFRS 2, Share-based Payment (effective for annual periods beginning on or after 1 January 2010). The amendments provide a clear basis to determine the classification of share-based payment awards in both consolidated and separate financial statements. The amendments incorporate into the standard the guidance in IFRIC 8 and IFRIC 11, which are withdrawn. The Bank does not expect the amendments to have any material effect on its financial statements.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

(bb) Adoption of new or revised standards and interpretations (continued)

IFRS 9, Financial Instruments Part 1: Classification and Measurement. IFRS 9 was issued in November 2009 and replaces those parts of IAS 39 relating to the classification and measurement of financial assets. The standard requires that financial assets are classified into two measurement categories: those to be measured at fair value, and those to be measured at amortised cost. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. While adoption of IFRS 9 is mandatory from 1 January 2013, earlier adoption is permitted. The Bank is considering the implications of the standard on its financial statements.

Amendment to IFRIC 14, 'Payments of a minimum funding requirement' (effective for annual periods beginning on or after 1 January 2011). This amendment will have a limited impact as it applies only to companies that are required to make minimum funding contributions to a defined benefit pension plan.

IFRIC 19, Extinguishing financial liabilities with equity instruments (effective for annual periods beginning on or after 1 July 2010). This interpretation clarifies the accounting when an entity renegotiates the terms of its debt with the result that the liability is extinguished through the debtor issuing its own equity instruments to the creditor. A gain or loss is recognised in the profit and loss account based on the fair value of the equity instruments compared to the carrying amount of the debt. IFRIC 19 is not relevant to the Bank's operations.

Improvements to International Financial Reporting Standards (issued in April 2009; amendments to IFRS 2, IAS 38, IFRIC 9 and IFRIC 16 are effective for annual periods beginning on or after 1 July 2009; amendments to IFRS 5, IFRS 8, IAS 1, IAS 7, IAS 17, IAS 36 and IAS 39 are effective for annual periods beginning on or after 1 January 2010). The improvements consist of a mixture of substantive changes and clarifications in the following standards and interpretations: clarification that contributions of businesses in common control transactions and formation of joint ventures are not within the scope of IFRS 2; clarification of disclosure requirements set by IFRS 5 and other standards for non-current assets (or disposal groups) classified as held for sale or discontinued operations; requiring to report a measure of total assets and liabilities for each reportable segment under IFRS 8 only if such amounts are regularly provided to the chief operating decision maker; amending IAS 1 to allow classification of certain liabilities settled by entity's own equity instruments as non-current; changing IAS 7 such that only expenditures that result in a recognised asset are eligible for classification as investing activities; allowing classification of certain long-term land leases as finance leases under IAS 17 even without transfer of ownership of the land at the end of the lease; providing additional guidance in IAS 18 for determining whether an entity acts as a principal or an agent; clarification in IAS 36 that a cash generating unit shall not be larger than an operating segment before aggregation; supplementing IAS 38 regarding measurement of fair value of intangible assets acquired in a business combination; amending IAS 39 (i) to include in its scope option contracts that could result in business combinations, (ii) to clarify the period of reclassifying gains or losses on cash flow hedging instruments from equity to profit or loss for the year and (iii) to state that a prepayment option is closely related to the host contract if upon exercise the borrower reimburses economic loss of the lender; amending IFRIC 9 to state that embedded derivatives in contracts acquired in common control transactions and formation of joint ventures are not within its scope; and removing the restriction in IFRIC 16 that hedging instruments may not be held by the foreign operation that itself is being hedged. The Bank does not expect the amendments to have any material effect on its financial statements.

The International Financial Reporting Standard for Small and Medium-sized Entities (issued in July 2009) is a self-contained standard, tailored to the needs and capabilities of smaller businesses. Many of the principles of full IFRS for recognising and measuring assets, liabilities, income and expense have been simplified, and the number of required disclosures have been simplified and significantly reduced. The Bank is not eligible to apply the IFRS for SMEs due to the public accountability of its banking business.

Unless otherwise described above, the new standards and interpretations are not expected to significantly affect the Bank's financial statements.

NOTES TO THE FINANCIAL STATEMENTS (continued)

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NOTE 4 FINANCIAL RISK MANAGEMENT

Risk Management

Risk management is one of the Bank’s strategic tasks. Risk management strategy has been developed for the Bank’s risk management, which covers management of the following risks: credit risk and residual risk, operational risk, market risk, interest rate risk, foreign currency risk, liquidity risk, concentration risk, country risk and other risks.

For the purpose of managing these risks, internal risk management policies and procedures have been developed which are approved by the Bank’s Council and/or Board and implemented by the responsible units of the Bank.

The Board of the Bank is responsible for the development and effective functioning of the risk management system and ensuring the identification and management of the Bank’s risks, including estimation, evaluation, oversight and preparation of risk reports through implementing the risk identification and management policy set by the Bank’s Council and other documents connected with risk management.

The main unit responsible for determination, evaluation and oversight of the risks is the Risk Management Department, which is an independent unit whose functions are separated from the functions of the business units.

The risk management system is being constantly improved in accordance with the Bank’s activities and external conditions influencing these activities. The regular oversight of this process is performed by the Internal Audit Department.

(a) Credit risk

Credit risk is the risk of incurring losses in the event that a borrower (debtor) or a business partner is unable to fulfil its obligations to the Bank in accordance with the provisions of the contract. Credit risk is present in the Bank’s operations where the Bank makes claims against another person and which are reflected in the Bank’s balance sheet and off-balance sheet items.

The Bank’s principles for evaluation, oversight and acceptance of credit risk are described and approved in its Loan Policy, Business Partner Risk Policy and Investment Portfolio Policy.

The Bank divides up and oversees its credit risk by setting limits of various types and categories: acceptable risk limits for each borrower, group of related borrowers, geographical regions, business sectors, type and value of collateral, currency, term and ratings granted by international agencies.

Credit risk exposures are monitored on a revolving basis through regular assessments of borrowers’ ability to meet interest and principal repayments and limits are adjusted as appropriate. The Bank’s exposure to credit risk is managed and minimised by obtaining collaterals and guarantees against credit exposures that are registered in the name of the Bank. The fair values of those are also reviewed on a regular basis.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 FINANCIAL RISK MANAGEMENT (continued)

Risk Management (continued)

(a) Credit risk (continued)

The table below shows credit risk exposures relating to on-balance sheet assets and off-balance sheet items before collateral held or other credit enhancements:

	31.12.2009.	31.12.2008.
	LVL	LVL
Credit risk exposures relating to on-balance sheet assets are as follows:		
Due from credit institutions	40,265,263	34,005,094
Loans to customers	67,618,082	65,252,570
Financial assets at fair value through profit or loss	10,138,920	4,201,311
Other assets	202,892	561,186
Total	<u>118,225,157</u>	<u>104,020,161</u>
 Credit risk exposures relating to off-balance sheet items are as follows:		
Contingent liabilities	537,955	111,429
Financial commitments	6,619,777	11,690,481
Total	<u>7,157,732</u>	<u>11,801,910</u>

(b) Market risk

The Bank takes on exposure to market risks. Market risks arise from open positions in interest rate and currency, all of which are exposed to general and specific market movements.

The Bank manages market risks by diversification of financial instruments portfolio, limits set for different types of financial instruments and application of sensitivity tests which show the impact of particular risks on the Bank's assets and equity.

(c) Currency risk

The Bank has exposure to the effects of fluctuations in prevailing foreign currency exchange rates as a result of its financial position and cash flows. The Bank seeks to match assets and liabilities denominated in foreign currencies in order to avoid foreign currency exposures. The Board has set limits on the level of exposure by currency, which is monitored on a daily basis. The Latvian banking legislation requires that open positions in each foreign currency may not exceed 10% of the Bank's equity and that the total foreign currency open position may not exceed 20% of the equity. During the year 2009 the Bank was in compliance with those limits (see Note 25).

The Bank's foreign currency risk evaluation is based on the following main principles:

- evaluation is made of changes to the Bank's assets, liabilities and off-balance sheet items as a result of exchange rate fluctuations;
- how the Bank's revenue/costs change with exchange rate fluctuations;
- performance of currency risk stress tests.

The main elements of currency risk management:

- currency risk evaluation;
- setting of limits and restrictions;
- monitoring of adherence to internal limits;
- performance of exchange rate stress tests and analysis of obtained results;
- entering into hedging relationships if necessary.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 FINANCIAL RISK MANAGEMENT (continued)

Risk Management (continued)

(c) Currency risk (continued)

Sensitivity Analysis

The following table shows the sensitivity of profit/loss and equity to currency exchange rate fluctuations at the end of the reporting period, with other conditions constant:

31.12.2009	Effect on equity		Effect on profit/loss		31.12.2008	Effect on equity		Effect on profit/loss	
	+10%	-10%	+10%	-10%		+10%	-10%	+10%	-10%
USD	-84	84	58	-58	USD	-84	84	32	-32
EUR	-5	5	-6	6	EUR	-5	5	11	-11
LVL	108	-108	1	-1	LVL	50	-50	1	-1
Other	0	0	0	0	Other	0	0	0	0
Total	19	-19	53	-53	Total	-39	39	44	-44

The following table shows the average annual sensitivity of profit/loss and equity to currency exchange rate fluctuations during the reporting period, with other conditions constant:

31.12.2009	Effect on equity		Effect on profit/loss		31.12.2008	Effect on equity		Effect on profit/loss	
	+10%	-10%	+10%	-10%		+10%	-10%	+10%	-10%
Total	69	-69	22	-22	Total	118	-118	62	-62

(d) Interest rate risk

Interest rate risk is the sensitivity of the financial position of the Bank to a change in market interest rates. In the normal course of business, the Bank encounters interest rate risk as a result of differences within maturities or interest re-fixing dates of respective interest-sensitive assets and liabilities. The risk is controlled by the Bank's Asset and Liability Committee, which sets limits on the level of mismatch of interest rate reprising and evaluates interest rate risk undertaken by the Bank (see Note 27).

In order to evaluate interest rate risk, evaluation is made of the impact of interest rate changes on the Bank's economic value, including evaluation of interest rate risk from the revenue perspective and the economic value perspective. In addition, interest rate risk stress testing is performed.

The main elements of interest rate risk management:

- evaluation of interest rate risk sensitivity;
- setting of internal limits (limit of reduction in economic value and for total duration of securities portfolio);
- monitoring of adherence to internal limits;
- performance of interest rate stress tests and analysis of obtained results;
- entering into hedging relationships if necessary.

The following changes in interest rates are applied to the sensitivity analysis: all items except for deposits are subject to rate changes of +/-100 base points, while deposits are subject to rate changes of +/-50 base points.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 FINANCIAL RISK MANAGEMENT (continued)

Risk Management (continued)

(d) Interest rate risk (continued)

The following table shows the sensitivity of profit/loss and equity to interest rate fluctuations with other conditions constant:

31.12.2009	Effect on equity		Effect on profit/loss		31.12.2008	Effect on equity		Effect on profit/loss	
	+100 bps	-100 bps	+100 bps	-100 bps		+100 bps	-100 bps	+100 bps	-100 bps
USD	-196	196	206	-206	USD	-192	192	241	-241
EUR	-51	51	190	-190	EUR	-70	70	123	-123
LVL	-44	44	39	-39	LVL	-36	36	-9	9
Other	0	0	-2	2	Other	0	0	0	0
Total	-291	291	433	-433	Total	-298	298	355	-355

The following table shows the average annual sensitivity of profit/loss and equity to interest rate fluctuations, with other conditions constant:

31.12.2009	Effect on equity		Effect on profit/loss		31.12.2008	Effect on equity		Effect on profit/loss	
	+100 bps	-100 bps	+100 bps	-100 bps		+100 bps	-100 bps	+100 bps	-100 bps
Total	-272	272	434	-434	Total	-341	341	212	-212

(e) Liquidity risk

The Bank is exposed to daily calls on its available cash resources from short-term liquid investments. The relationship between the maturity of assets and liabilities, as well as off-balance sheet items is indicative of liquidity risk and the extent to which it may be necessary to raise funds to meet outstanding obligations.

The Bank does not maintain cash resources to meet all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Board sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

It is unusual for banks to be completely matched, as transacted business is often of uncertain term and of different types (see Note 26). An unmatched position potentially enhances profitability, but also increases the risk of losses.

The maturities of assets and liabilities and the ability to replace, at an acceptable cost, interest-bearing liabilities as they mature are important factors in assessing the liquidity of the Bank and its exposure to changes in interest rates and exchange rates.

The matching and controlled mismatching of the maturities of assets and liabilities is fundamental to the daily liquidity management of the Bank.

The Bank uses the following methods for evaluation of liquidity risk:

- preparation of maturity analysis (for all currencies and separately for individual currencies);
- calculation of the liquidity ratio, monitoring of adherence to liquidity ratio regulations;
- stress testing.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 FINANCIAL RISK MANAGEMENT (continued)

(e) Liquidity risk (continued)

The following are the main elements of liquidity risk management:

- being in compliance with liquidity ratio regulations;
- setting of the liquidity net position limit;
- setting of restriction for attracting deposits;
- monitoring of adherence to liquidity limits;
- conducting liquidity stress tests and analysis of results obtained;
- recommendations for resolving liquidity problems.

In accordance with FCMC requirements, the Bank maintains sufficient liquid assets to meet its liabilities in the amount which is not less than 30% of the Bank's current liabilities.

(f) Capital adequacy

Capital adequacy refers to the sufficiency of the Bank's capital resources to cover risks resulting from the Bank's operating activities.

In order to calculate the capital for risks to which minimal capital requirements are set, according to the Financial and Capital Market Commission's (FCMC) regulations on preparation of report on minimal capital requirements, capital requirements are calculated using the following approaches and methods:

- the capital requirements for the credit risk are calculated using the standardised approach,
- "simple method of financial security" is used in order to decrease the credit risk,
- the capital requirements for the foreign exchange risks, capital requirements for the commodities risk, capital requirements for the position risk of debt securities and equities are calculated using the standardised approach,
- the capital requirements for the general risk of debt securities are calculated using maturity method;
- the capital requirements for the operational risk are calculated using the basic index approach.

The Bank also evaluates whether compliance with the minimal capital requirements ensures that the capital of the Bank is sufficient to cover all possible losses associated with all of the above mentioned risks.

Moreover, the Bank has developed internal documentation and regulations according to which it determines the amount of necessary capital for substantial risks to which minimal capital requirements are not set (e.g., interest rates risk, liquidity risk, country risk, and other substantial risks).

Calculated in accordance with the FCMC requirements, the Bank's capital adequacy ratio as at 31 December 2009 was 16.21%, which is above the minimum required by the FCMC. FCMC requires Latvian banks to maintain a capital adequacy ratio of 8% of weighted assets and off-balance sheet items which are calculated in accordance with the rules set by FCMC (see also Note 24). Bank's capital adequacy ratio as at 31 December 2008 was 15.67%.

(g) Operational risk

Operational risk is the possibility of incurring losses as a result of inadequate or unsuccessful developments in the Bank's internal processes, human and systemic actions, or influence of external conditions. Operational risk is defined as the risk of a reduction in the Bank's revenue/ incurring of additional costs (and a resulting reduction of the equity) due to erroneous transactions with customers/business partners, information processing, adoption of ineffective decisions, insufficient human resources or insufficient planning for the influence of external conditions.

The Bank has established and maintains an Operational Risk Event and Loss database in which internal data on operational risk events and associated losses are collected, processed and organised.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 4 FINANCIAL RISK MANAGEMENT (continued)

(g) Operational risk (continued)

The main elements of operational risk management are:

- operational risk monitoring;
- operational risk control and minimisation:
 - development of internal regulatory documents which prevent/reduce the likelihood of operational events;
 - segregation of duties;
 - control over internal limits;
 - adherence to the procedures in the use of IT and other Bank's resources;
 - appropriate training of employees;
 - regular review of supporting documents for transactions and account balances.

(h) Concentration risk

Transaction concentration risk is each and every risk deal or group of risk deals that could cause Bank to suffer such losses that may endanger the liquidity of the Bank or its ability to continue on a going concern. Concentration risk arises from significant risk deals with Clients or Group of inter-related Clients or risk deals with Clients with common risk factors (e.g., economy sector, geographical region, currency, instrument used for decrease of credit risk (one type of collateral or one provider of collateral, etc.)).

In order to control transaction concentration risk Bank has set limits for investments into various types of assets, instruments, markets, etc. Limit is a numerical threshold applied to various types of investments serving as an instrument for limiting and controlling the risk.

Country risk is one of significant transaction concentration risks. Country risk – country partner risk – is the possibility of incurring losses if the Bank's assets are located in a country where, due to changes in its economic and political factors, the Bank may experience problems in recovering its assets within the agreed time and amount. The reasons of default by partners and issuers are primarily currency devaluation, unfavourable legislative changes, creation of new restrictions and barriers as well as other, including force majeure, factors.

In order to control concentration risks following limits were set:

- currency risk limits;
- credit rating group limits;
- financial market operations risk limits;
- limits on open currency positions and cash, limits on allowable loss on trading with foreign currencies;
- limits on allowable loss from trading with financial instruments portfolios;
- limits on high risk deals;
- limits on transactions with parent bank;
- limits on crediting programmes.

Control, analysis and review of fulfilment of these limits is performed.

International rating organisations data (including credit ratings and their dynamics), economic indicators of the country and other relevant information is used for risk analysis.

The main elements of risk control:

- setting of internal limits for regions, countries, and by transaction types in individual countries;
- monitoring of adherence to internal limits;
- analysis and monitoring of country risk;
- review of internal limits.

Asset, liability and off-balance sheet country risk applies to the country which is considered to be the primary country where the client conducts its business activities. If a loan is granted to a resident of another country using collateral which is physically located in a country other than the resident country of the legal entity, the state risk is transferred to the country where the loan collateral is actually located.

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NOTE 5 INTEREST INCOME AND EXPENSE

	2009	2008
	LVL	LVL
Interest income		
Loans and advances to legal entities	5,309,359	5,697,492
Loans and advances to private individuals	288,558	418,321
Balances due from banks	2,861,783	1,428,109
Trading securities	625,435	405,071
Total interest income	9,085,135	7,948,993
Interest expense		
Due to private individuals	(574,548)	(757,628)
Due to legal entities	(4,328,310)	(1,937,337)
Balances due to banks	(133,512)	(356,973)
Balances due to Bank of Latvia	(14,351)	(155,713)
Other liabilities	(207,749)	(185,087)
Total interest expense	(5,258,470)	(3,392,738)
Net interest income	3,826,665	4,556,255

NOTE 6 FEE AND COMMISSION INCOME AND EXPENSE

Fee and commission income		
Money transfers	1,800,602	1,674,726
Loan related fees	365	2,150
Trust activities	518	11,166
Accounts servicing	102,911	67,891
Letters of credit	47,775	56,886
Sale of deposit certificates	7,228	17,461
Commission income on transactions with financial instruments	60,359	-
Commission income on current accounts	23,945	28,709
Income from general services	89,680	67,502
Commissions – DIGIPAS	10,889	13,871
Interbank commission income	18,598	18,266
Commission for dealing with cards	31,627	13,261
Income from currency exchange	33,542	25,820
Other income	24,686	13,311
Total fee and commission income	2,252,725	2,011,020
Fee and commission expense		
Money transfers	(539,236)	(419,922)
Other expense	(50,892)	(103,658)
Total fee and commission expense	(590,128)	(523,580)
Net fee and commission income	1,662,597	1,487,440

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 7 ADMINISTRATIVE EXPENSE

	2009	2008
	LVL	LVL
Remuneration paid to personnel	1,465,479	1,404,898
Rent expense	398,938	369,290
Office and equipment maintenance	108,102	81,083
Remuneration paid to the members of the Council and the Board	217,048	277,370
Security services	15,244	12,603
Public utilities	39,826	29,078
State compulsory social insurance contributions	265,728	243,911
Pension insurance	82,344	75,584
Communication expense	200,778	165,187
Consulting and professional fees	264,100	154,822
Set-up and maintenance costs of information systems	56,899	35,374
Business trips	53,263	60,068
Introduction of credit cards	4,027	4,800
Transportation	49,534	72,338
Sponsorship	13,206	19,806
Health insurance	11,761	30,150
Advertising and marketing	2,328	68,798
Personnel training in connection with EU structural funds	-	1,861
Penalties	2,738	317
Other administrative expense	139,242	221,779
	<u>3,390,585</u>	<u>3,329,117</u>

The average number of staff employed by the Bank in 2009 was 103 (2008: 94).

NOTE 8 INCOME TAX EXPENSE

	2009	2008
	LVL	LVL
Corporate income tax for the reporting year	-	382,559
Amount of tax paid abroad	257,267	-
Decrease in provisions for deferred tax (see Note 19)	4,870	(880)
Total corporate income tax	<u>262,137</u>	<u>381,679</u>

Corporate income tax differs from the theoretically calculated taxation at the 15% rate as stipulated by the law (see below):

Profit before income tax	<u>315,690</u>	<u>1,355,535</u>
Theoretically calculated tax at a tax rate of 15%	47,354	203,330
(Profit) / loss from revaluation of securities at fair value through profit and loss account, net	(59,008)	169,719
Other expenses not deductible for tax purposes	16,524	22,994
Amount of tax paid abroad	257,267	-
Tax discount for donations	-	(14,364)
Corporate income tax expense	<u>262,137</u>	<u>381,679</u>

Deferred income tax is calculated by using the enacted tax rate – 15%.

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 9 CASH AND BALANCES WITH THE BANK OF LATVIA

	31.12.2009	31.12.2008
	LVL	LVL
Cash	592,228	724,009
Balances on demand with the Bank of Latvia	6,072,976	5,173,033
	<u>6,665,204</u>	<u>5,897,042</u>

Balances on demand with Bank of Latvia reflect the balance of the Bank's correspondent account, on which interest is paid in the amount of the compulsory reserve requirement.

Demand deposits with the Bank of Latvia include an obligatory reserve maintained in accordance with Bank of Latvia regulations. The regulations specify the minimum level of the average balance to be maintained on the Bank's correspondent account with the Bank of Latvia during each month, whilst allowing funds in the account to be used in an unrestricted manner on individual days. The minimum level of the average balance to be maintained on the Bank's correspondent account with the Bank of Latvia during the period from 24/12/2009 till 23/01/2010 has been set in amount of 5,471,504 LVL.

The Bank was in compliance with the reserve requirement Bank of Latvia during the reporting period.

NOTE 10 BALANCES DUE FROM BANKS

	31.12.2009	31.12.2008
	LVL	LVL
Due from Republic of Latvia credit institutions	734,517	2,544,086
Due from non-OECD credit institutions	16,840,076	25,504,411
Due from OECD credit institutions	22,690,670	5,956,597
	<u>40,265,263</u>	<u>34,005,094</u>

The following table discloses balances due from banks between demand and term deposits:

On demand	28,453,524	12,165,731
Balances with maturity of three months or less	7,312,421	3,683,706
Other balances due from banks	4,499,318	18,155,657
	<u>40,265,263</u>	<u>34,005,094</u>

The following table discloses balances due from banks according to their ratings as at 31 December 2009 and 31 December 2008:

Rating	31.12.2009		31.12.2008	
	Due from banks		Due from banks	
	LVL	%	LVL	%
From Aaa to Aa3	9,983,336	24.79%	6,651,714	19.56%
From A1 to A3	12,583,443	31.25%	175,900	0.52%
From Baa1 to Baa3	830,609	2.06%	-	0.0%
From Ba1 to Ba3	-	0.0%	737,944	2.17%
From B1 to B3	16,649,289	41.35%	26,376,467	77.57%
	<u>40,046,677</u>	<u>99.45%</u>	<u>33,942,025</u>	<u>99.82%</u>
Without rating	218,586	0.55%	63,069	0.18%
	<u>40,265,263</u>	<u>100.0%</u>	<u>34,005,094</u>	<u>100.0%</u>

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 11 LOANS AND ADVANCES TO CUSTOMERS

Analysis of loans by client type and by products

	31.12.2009	31.12.2008
	LVL	LVL
Loans to legal entities	66,072,917	61,690,150
Loans to private individuals, except for mortgages	2,043,606	2,709,293
Loans to private individuals – private enterprises	60,817	65,935
Mortgages	2,567,441	1,938,726
Less: provisions for loan impairment	<u>(3,126,699)</u>	<u>(1,151,534)</u>
Total loans and advances to customers	<u>67,618,082</u>	<u>65,252,570</u>

The following table discloses changes in provisions for loan impairment during 2009:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages	Total
Provisions for loan impairment as at 1 January 2009	1,151,410	124	-	1,151,534
Increase in provisions for loan impairment for the year	2,072,591	144,271	45,984	2,262,846
Write off	(290,138)	-	-	(290,138)
Impact of foreign currency revaluation	2,457	-	-	2,457
Provisions for loan impairment as at 31 December 2009	<u>2,936,320</u>	<u>144,395</u>	<u>45,984</u>	<u>3,126,699</u>

The following table discloses changes appeared in provisions for loan impairment during 2008:

	Loans to legal entities	Loans to private individuals, except for mortgages	Total
Provisions for loan impairment as at 1 January 2008	540,198	-	540,198
Increase in provisions for loan impairment for the year	594,782	124	594,906
Impact of foreign currency revaluation	16,430	-	16,430
Provisions for loan impairment as at 31 December 2008	<u>1,151,410</u>	<u>124</u>	<u>1,151,534</u>

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NOTES TO THE FINANCIAL STATEMENTS (continued)

NOTE 11 LOANS AND ADVANCES TO CUSTOMERS (continued)

The concentration of risks in the credit portfolio based on the economical industries is as follows:

	2009		2008	
	LVL	%	LVL	%
Trade and commercial activities	25,586,264	36.17%	24,590,848	37.03%
Private individuals	4,671,865	6.60%	4,713,951	7.10%
Agriculture and food industry	1,982,212	2.80%	2,592,300	3.90%
Construction and operations with real estate	10,344,435	14.62%	10,405,876	15.67%
Transport and communication	7,112,020	10.05%	7,630,190	11.49%
Industry	542,071	0.77%	69,351	0.10%
Tourism and hotel services, restaurant business	3,276,127	4.63%	3,346,613	5.04%
Other	17,229,787	24.36%	13,054,975	19.67%
Loans and advances to customers (before provisions for impairment)	70,744,781	100.%	66,404,104	100%

As at 31 December 2009, the total amount of issued loans to 10 largest clients was LVL 30,504,219 (2008: 23,621,281 LVL), which comprises 43.12% of the total credit portfolio (2008: 36%). As at 31 December 2009, loans and advances to 10 largest clients were secured by deposits in total amount of LVL 5,323,740 (2008: 1,254,509 LVL).

The following table below shows the information about collateral as at 31 December 2009:

	Loans to legal entities	Loans to private individuals, except for mortgages	Loans to private individuals – private enterprises	Mortgages	Total
Unsecured loans	1,061,346	102,661	-	-	1,164,007
Loan collateralised by:					
- residential real estate	4,702,030	1,038,816	-	283,149	6,023,995
- other real estate	35,889,394	902,130	-	2,073,451	38,864,975
- tradeable securities	3,066,070	-	60,817	-	3,126,887
- cash deposits	6,136,993	-	-	210,841	6,347,834
- other assets	15,217,083	-	-	-	15,217,083
Total loans and advances to customers	66,072,916	2,043,607	60,817	2,567,441	70,744,781

The following table below shows the information about collateral as at 31 December 2008:

	Loans to legal entities	Loans to private individuals, except for mortgages	Loans to private individuals – private enterprises	Mortgages	Total
Unsecured loans	286,447	129,938	-	-	416,385
Loan collateralised by:					
- residential real estate	3,656,977	1,037,218	-	327,424	5,021,619
- other real estate	40,635,591	894,744	-	1,611,302	43,141,637
- tradeable securities	3,236,622	-	65,935	-	3,302,557
- cash deposits	3,158,535	647,393	-	-	3,805,928
- other assets	10,715,978	-	-	-	10,715,978
Total loans and advances to customers	61,690,150	2,709,293	65,935	1,938,726	66,404,104

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NOTE 11 LOANS AND ADVANCES TO CUSTOMERS (continued)

The following table shows the loans outstanding as at 31 December 2009 by credit quality.

	Loans to legal entities	Loans to private individuals, except for mortgages	Loans to private individuals – private enterprises	Mortgages	Total
<i>Neither past due nor impaired</i>					
- Loans to big size entities	489,951	-	-	-	489,951
- Loans to medium size entities	5,322,532	-	-	-	5,322,532
- Loans to small size entities	49,472,434	-	60,817	-	49,533,251
- Loans to private individuals	-	864,326	-	2,027,201	2,891,527
Total neither past due nor impaired	55,284,917	864,326	60,817	2,027,201	58,237,261
<i>Past due but not impaired</i>					
- past due 30 days	1,298,328	249,325	-	318,506	1,866,159
- past due over 360 days	328	-	-	-	328
Total past due, but not impaired	1,298,656	249,325	-	318,506	1,866,487
<i>Individually impaired loans (total amount)</i>					
- not past due	3,852,823	915,367	-	139,454	4,907,644
- past due up to 30 days	177,231	-	-	45,937	223,168
- past due 30 – 90 days	12,399	-	-	-	12,399
- past due 91 – 180 days	14,308	195	-	-	14,503
- past due 181 – 360 days	81,848	14,393	-	-	96,241
- past due over 360 days	5,350,735	-	-	36,343	5,387,078
Total individually impaired loans (total amount)	9,489,344	929,955	-	221,734	10,641,033
Less: provisions for loan impairment	(2,936,320)	(144,395)	-	(45,984)	(3,126,699)
Total loans and advances to customers	63,136,597	1,899,211	60,817	2,521,457	67,618,082

Loans past due, but not impaired include all amounts due from borrowers. Amount actually overdue as at 31 December 2009 were 910,528 LVL.

Loans past due and individually impaired include all amounts due from borrowers. Amount actually overdue as at 31 December 2009 was 5,678,201 LVL.

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NOTE 11 LOANS AND ADVANCES TO CUSTOMERS (continued)

The following table shows the loans outstanding as at 31 December 2008 by credit quality:

	Loans to legal entities	Loans to private individuals, except for mortgages	Loans to private individuals – private enterprises	Mortgages	Total
<i>Neither past due nor impaired</i>					
- Loans to medium size entities	5,395,627	-	-	-	5,395,627
- Loans to small size entities	51,242,363	-	-	-	51,242,363
- Loans to private individuals	-	2,708,859	65,936	1,938,726	4,713,521
Total neither past due nor impaired	56,637,990	2,708,859	65,936	1,938,726	61,351,511
<i>Past due but not impaired</i>					
- past due 30 – 90 days	1,254,288	-	-	-	1,254,288
- past due over 360 days	274	-	-	-	274
Total past due, but not impaired	1,254,562	-	-	-	1,254,562
<i>Individually impaired loans (total amount)</i>					
- not past due	109,966	-	-	-	109,966
- past due up to 30 days	39	434	-	-	473
- past due 91 – 180 days	3,066,644	-	-	-	3,066,644
- past due over 360 days	620,948	-	-	-	620,948
Total individually impaired loans (total amount)	3,797,597	434	-	-	3,798,031
Less: provisions for loan impairment	(1,151,410)	(124)	-	-	(1,151,534)
Total loans and advances to customers	60,538,739	2,709,169	65,936	1,938,726	65,252,570

The primary factors that the Bank considers in determining whether a loan is impaired are its overdue status and realisability of related collateral, if any.

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NOTE 11 LOANS AND ADVANCES TO CUSTOMERS (continued)

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2009 was as follows:

	Loans to legal entities	Loans to private individuals, except for mortgages	Mortgages
<i>Fair value of collateral – loans past due but not impaired</i>			
- residential real estate	292,574	638,849	-
- other real estate	1,029,700	-	565,000
- other assets	2,869,787	-	-
<i>Fair value of collateral – individually impaired loans</i>			
- residential real estate	1,092,911	12,700	53,300
- other real estate	16,959,042	1,100,000	310,000
- other assets	4,366,047	933,800	-
Total	26,610,061	2,685,349	928,300

The fair value of collateral in respect of loans past due but not impaired and in respect of loans individually determined to be impaired at 31 December 2008 was as follows:

	<u>Loans to legal entities</u>
<i>Fair value of collateral - loans past due but not impaired</i>	
- other real estate	6,957,760
<i>Fair value of collateral - individually impaired loans</i>	
- other real estate	5,242,512
- other assets	1,653,484
Total	13,853,756

The Bank's policy is to classify each loan as 'neither past due nor impaired' until specific objective evidence of impairment of the loan is identified. The balance sheet value of the each category of loans and advances to clients equals to its fair value as at 31 December 2008 and 2009.

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NOTE 12 FINANCIAL ASSETS AT FAIR VALUE THROUGH PROFIT AND LOSS

	31.12.2009	31.12.2008
	LVL	LVL
Latvian government securities	6,455,228	2,031,139
Non-OECD region corporate debt securities	1,032,302	927,682
Latvian corporate debt securities	792,693	1,242,490
Unquoted securities	1,858,697	-
	<u>10,138,920</u>	<u>4,201,311</u>

Analysis of debt securities based on classification categories as at 31 December 2009 and 31 December 2008 is laid out below.

Category 1 – includes securities with directly available market prices (regulated market) and having high liquidity allowing for quick sale for the balance sheet value.

Category 2 – includes securities which are publicly traded but having no quoting prices for at least one year or no transactions made. Fair value of these securities is calculated applying comparative methods.

Category 3 – securities which do not classify as either Category 1 or Category 2. For these securities fair value is calculated used various analytical methods which are based on analysis of similar securities and interpolation of their prices, as well as other factors.

	31.12.2009	31.12.2008
	LVL	LVL
Category 1	8,280,223	4,025,204
Category 3	1,858,697	176,107
	<u>10,138,920</u>	<u>4,201,311</u>

Movement of securities included into Category 3 was as follows:

	2009	2008
	LVL	LVL
Category 3 at the beginning of the year	176,107	-
Purchase of securities	1,697,203	176,107
Sale of securities	(176,107)	-
Impact of foreign currency revaluation	161,494	-
Category 3 at the end of the year	<u>1,858,697</u>	<u>176,107</u>

Financial assets at fair value through profit or loss are accounted at fair value that also reflects impairment loss related to credit risk. As the financial assets are accounted at fair value based on the market prices, the Bank does not analyse and follow any impairment indicators.

The following table discloses debt securities by issuers' ratings as at 31 December 2009 and 31 December 2008:

Rating	31.12.2009		31.12.2008	
	Securities		Securities	
	LVL	%	LVL	%
From A1 to A3	-	0.00%	2,031,139	48.3%
From Baa1 to Baa3	6,455,228	63.67%	-	-
From Ba1 to Ba3	75,671	0.75%	883,322	21.0%
From B1 to B3	870,428	8.58%	754,419	18.0%
Under B3	496,396	4.90%	-	-
	<u>7,897,723</u>	<u>77.90%</u>	<u>3,668,880</u>	<u>87.3%</u>
Without rating	2,241,197	22.10%	532,431	12.7%
	<u>10,138,920</u>	<u>100.0%</u>	<u>4,201,311</u>	<u>100.0%</u>

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NOTE 13 INTANGIBLE ASSETS

The following changes in the Bank's intangible assets took place during the year ended 31 December 2008 and 31 December 2007:

	2009	2008
	Software	Software
	LVL	LVL
Cost		
As at the beginning of the year	644,636	428,706
Additions	128,659	110,001
Advance payments	5,450	105,929
As at end of the year	778,745	644,636
Amortisation		
Accumulated amortisation at the beginning of the year	229,827	164,948
Charge for the year	87,178	64,879
Accumulated amortisation at the end of the year	317,005	229,827
Net book value at the beginning of the year	414,809	263,758
Net book value at the end of the year	461,740	414,809

NOTE 14 PROPERTY AND EQUIPMENT

The following changes in the Bank's property and equipment took place during the year ended 31 December 2009:

	Transport	Computers	Office equipment	Leasehold improvements	Total
	LVL	LVL	LVL	LVL	LVL
Cost					
31.12.2008.	16,750	333,929	419,648	70,932	841,259
Disposals	-	(729)	-	-	(729)
Additions	-	57,956	-	-	57,956
Reclassified	-	27,771	(27,771)	-	-
Advance payments	-	4,396	-	-	4,396
31.12.2009.	16,750	423,323	391,877	70,932	902,882
Depreciation					
31.12.2008.	5,304	182,681	59,805	-	247,790
On disposals	-	(708)	-	-	(708)
Charge for 2009.	3,350	112,904	56,937	4,299	177,490
31.12.2009.	8,654	294,877	116,742	4,299	424,572
Net book value					
31.12.2008.	11,446	151,248	359,843	70,932	593,469
Net book value					
31.12.2009	8,096	128,446	275,135	66,633	478,310

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NOTE 14 PROPERTY AND EQUIPMENT (continued)

The following changes in the Bank's property and equipment took place during the year ended 31 December 2008:

	Transport LVL	Computers LVL	Office equipment LVL	Leasehold improvements LVL	Total LVL
Cost					
31.12.2007	16,750	284,758	137,154	-	438,662
Disposals	-	(7,853)	(1,697)	-	(9,550)
Additions	-	27,258	193,503	70,932	291,693
Advance payments	-	29,766	90,688	-	120,454
31.12.2008	16,750	333,929	419,648	70,932	841,259
Depreciation					
31.12.2007	1,954	113,552	43,851	-	159,357
On disposals	-	(7,853)	-	-	(7,853)
Charge for 2008	3,350	76,982	15,954	-	96,286
31.12.2008	5,304	182,681	59,805	-	247,790
Net book value					
31.12.2007	14,796	171,206	93,303	-	279,305
31.12.2008	11,446	151,248	359,843	70,932	593,469

NOTE 15 DUE TO CUSTOMERS

(a) Analysis of groups by customers

	31.12.2009 LVL	31.12.2008 LVL
Legal entities		
- current/settlement accounts	81,629,319	65,247,039
- term deposits	18,597,348	11,137,400
Private individuals		
- current/settlement accounts	3,398,845	1,437,070
- term deposits	5,607,973	10,318,817
Total customer accounts:	109,233,485	88,140,326
Sector profile:		
Private companies	94,719,573	70,899,292
Private individuals	9,006,818	11,755,887
Financial institutions	5,493,446	5,479,309
Non-profit institutions	9,918	2,160
Central government	3,730	3,678
Total customer accounts:	109,233,485	88,140,326

(b) Analysis by place of residence

Residents	13,368,820	16,695,550
Non-residents	95,864,665	71,444,776
Total customer accounts:	109,233,485	88,140,326

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NOTE 15 DUE TO CUSTOMERS (continued)

During the year ended 31 December 2009 average interest rate on term deposits due to customers was 8.67% (2008: 7.1%) and average interest rate on demand deposits was 0% to 4.5% (2008: 0% - 4.4%). All deposits have fixed interest rates.

Economic sector concentration within customer accounts is as follows:

	2009		2008	
	LVL	%	LVL	%
Cities and municipalities	-		3,677	0.01
Manufacturing	1,017,596	0.93	1,509,285	1.71
Building and real estate	4,610,230	4.22	2,952,401	3.35
Trade and commercial activities	41,386,853	37.89	26,238,739	29.77
Financial and insurance services	24,360,190	22.30	22,354,851	25.36
Transport and communications	23,696,605	21.69	14,744,367	16.73
Agriculture and food industries	261,193	0.24	144,634	0.16
Private individuals	9,006,818	8.25	11,755,375	13.34
Other	4,894,000	4.48	8,436,997	9.57
Total customer accounts	109,233,485	100.0	88,140,326	100

NOTE 16 BALANCES DUE TO BANKS

	31.12.2009	31.12.2008
	LVL	LVL
Loans against security pledge	-	742,161
Term deposit of bank AB „Pivdenny”	12,440	12,440
Loans from interbank market	-	5,757,019
Other interbank transactions	1,405,608	1,238,516
Accrued interest payable	264,240	145,097
	1,682,288	7,895,233

NOTE 17 OTHER FINANCIAL LIABILITIES

Liabilities in clearance	148,406	134,194
Settlements on behalf of a closed bank	11,656	11,656
VAT settlements	6,637	5,288
Other creditors	98,728	60,683
	265,427	211,821

NOTE 18 DEFERRED INCOME AND ACCRUED EXPENSES

Deferred income	69,875	80,240
Accrued annual leave expenses	157,517	184,900
Accrual for guarantee fund and FCMC financing	57,261	45,666
State social security contributions to be paid	37,920	-
Accrued commission expenses	110,572	17,525
Other accrued expenses	70,413	70,642
	503,558	398,973

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NOTE 19 DEFERRED INCOME TAX

The gross movement on the deferred income tax account is as follows:

	2009	2008
	LVL	LVL
Deferred income tax liability at the beginning of the reporting year	7,899	8,779
Deferred income tax liability (decrease) / increase during the reporting year (see Note 8)	4,870	(880)
Deferred tax liability at the end of the reporting year	<u>12,769</u>	<u>7,899</u>

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same taxation authority.

Deferred income tax has been calculated from the following temporary differences between assets and liabilities values for financial reporting and tax purposes:

	31.12.2009	31.12.2008
	LVL	LVL
<i>Deferred income tax liability:</i>		
Temporary difference on fixed assets depreciation	36,397	35,634
<i>Deferred income tax assets:</i>		
Temporary difference on accruals for unused annual leave	(23,628)	(27,735)
Deferred tax liability	<u>12,769</u>	<u>7,899</u>

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NOTE 20 DERIVATIVE FINANCIAL INSTRUMENTS

The Bank uses the following derivative financial instruments: currency forwards – agreements on currency acquisition in future, currency swaps – agreements on exchange one set of each cash flow for another.

The Bank's credit risk represents the potential cost to replace the forward contracts if counterparties fail to perform their obligation. To control the level of credit risk taken, the Bank assesses counterparties using the same techniques as for its lending activities.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and do not indicate the Bank's exposure to credit risks. The derivative instruments become favourable or unfavourable as a result of fluctuations in market interest rates or foreign exchange rates relative to their terms.

The Bank's notional amounts and fair values of derivative instruments held for trading are set out in the following table:

	31.12.2009.			31.12.2008.		
	Contract / notional amount	Fair value		Contract / notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
Currency swaps	1,683,427	31,768	(43,432)	22,193,699	271,352	(52,046)
Currency forwards	247,230		(69)	6,994,201	1,927	(90,597)
		31,768	(43,501)		273,279	(142,643)

The table below allocates the Bank's derivative cash flows as at 31 December 2009:

	Up to 1 month	1 to 3 months	Over 3 months	Total
Derivatives settled on a gross basis	LVL	LVL	LVL	LVL
Foreign exchange derivatives:				
- inflow	1,918,391	-	-	1,918,391
- outflow	(1,928,925)	-	-	(1,928,925)

The table below allocates the Bank's derivative cash flows as at 31 December 2008:

	Up to 1 month	1 to 3 months	Over 3 months	Total
Derivatives settled on a gross basis	LVL	LVL	LVL	LVL
Foreign exchange derivatives:				
- inflow	17,625,656	8,568,224	2,838,608	29,032,488
- outflow	(17,484,731)	(8,567,024)	(2,838,208)	(28,889,963)

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NOTE 21 SHARE CAPITAL

Issued and fully paid share capital as at 31 December 2007 was LVL 8,200,000. The share capital consisted of 8,200,000 ordinary shares with the nominal value of LVL 1 per share of which 8,200,000 were shares with voting rights.

In March 2008, the Bank made a decision to issue additional 6,000,000 shares with a nominal value of 1 LVL each. On 4 July 2008 the Ukrainian bank AB „Pivdenny” paid for acquisition of 2,000,000 shares and did not use the right to acquire the remaining 4,000,000 shares. On 24 October 2008 an extraordinary shareholders’ meeting approved decision No 3/2008 to increase share capital only by 2,000,000 shares, thus share capital of the Bank consisted of 10,200,000 shares. On 24 October 2008 the management of the Bank decided to approve the payment for 2,000,000 shares at actual amount and to determine that the share capital of the Bank constitutes 10,200,000 shares. The increase of the share capital was fully paid by 31 December 2008 and it was registered on 14 January 2009.

Issued and fully paid share capital as at 31 December 2008 comprises LVL 10,200,000. The paid share capital consists of 10,200,000 registered shares with the nominal value of LVL 1 per share of which 10,200,000 are shares with voting rights with the total nominal value of LVL 10,200,000.

On 3 November 2009 SIA HRG Investments and Vladis Spāre sold their shares of Bank (7.84% and 0.98% respectively) to Fortum Trade Services LTD.

As at 31 December 2008 the Bank’s shareholders were as follows:

	31.12.2009		31.12.2008	
	Paid-in share capital	% of total paid-in capital	Paid-in share capital	% of total paid-in capital
	LVL	%	LVL	%
AB „Pivdenny” bank	9,299,670	91.18	9,299,670	91.18
Haralds Āboliņš	110	-	110	-
HRG ieguldītāji	-	-	800,000	7.84
Vladis Spāre	-	-	100,000	0.98
Daiga Muravska	110	-	110	-
Oleksandr Kuperman	110	-	110	-
Fortum Trade Services LTD	900,000	8.82	-	-
	10,200,000	100.00	10,200,000	100.00

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NOTE 22 COMMITMENTS AND CONTINGENT LIABILITIES

Contingent liabilities

The following table discloses contingent liabilities:

	31.12.2009	31.12.2008
	LVL	LVL
Guarantee	-	32,580
Warranties	537,955	78,849
	<u>537,955</u>	<u>111,429</u>

The Bank has issued warranties in the amount of LVL 537,955. These warranties are secured by deposits placed with the Bank or money resources in the security accounts.

Financial commitments

The following table discloses the contractual amounts of the Bank's commitments to extend credit.

	31.12.2009	31.12.2008
	LVL	LVL
Letters of credit	39,576	3,766,068
Loans	6,580,201	7,924,413
	<u>6,619,777</u>	<u>11,690,481</u>

From which Bank's commitments relating to crediting were as follows:

Loan commitments	1,352,248	2,313,092
Undrawn credit lines	5,227,953	5,611,321
Total loan commitments	<u>6,580,201</u>	<u>7,924,413</u>

The total outstanding contractual amount of undrawn credit lines, letters of credit, and guarantees does not necessarily represent future cash requirements, as these financial instruments may expire or terminate without being funded. The loan commitments are denominated in the following currencies:

	31.12.2009	31.12.2008
	LVL	LVL
USD	4,339,015	6,648,533
EUR	394,975	900,832
Other currencies	1,846,211	375,048
Total	<u>6,580,201</u>	<u>7,924,413</u>

Commitment under operating lease agreement

The Bank has entered into an operating lease agreement for its office premises. The lease agreement expires in June 2025. The non-cancellable lease liabilities payable within a year are LVL 439,657.

Where the Bank is the lessee, the future lease payments under concluded operating lease agreements are as follows:

	31.12.2009	31.12.2008
	LVL	LVL
Up to 1 year	439,657	381,100
1 to 5 years	2,536,673	2,183,161
Over 5 years	5,720,167	6,259,201
Total	<u>8,696,497</u>	<u>8,823,462</u>

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NOTE 22 COMMITMENTS AND CONTINGENT LIABILITIES (continued)

Funds under trust management

	31.12.2009	31.12.2008
	LVL	LVL
Assets under trust		
Loans	-	120,155
	<u>-</u>	<u>120,155</u>
Liabilities under trust		
Private individuals	-	120,155
	<u>-</u>	<u>120,155</u>

Assets pledged and restricted

As at 31 December 2008 and 2009 the Bank had the following assets pledged:

	2009		2008	
	Assets pledged	Related liabilities	Assets pledged	Related liabilities
Financial assets at fair value through profit and loss	-	-	1,148,777	742,940
Balances due from banks	-	-	870,772	-
Loans and advances to customers	1,406,685	1,424,349	-	-
Total	<u>1,406,685</u>	<u>1,424,349</u>	<u>2,019,549</u>	<u>742,940</u>

NOTE 23 CASH AND CASH EQUIVALENTS

	31.12.2009	31.12.2008
	LVL	LVL
Cash and balances on demand with the Bank of Latvia	6,665,204	5,897,042
Due from banks with original maturity of 3 months or less	35,765,945	15,849,437
Due to banks	(1,682,288)	(7,895,233)
	<u>40,748,861</u>	<u>13,851,246</u>

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NOTE 24 CAPITAL ADEQUACY

The Bank's calculation of the capital adequacy ratio according to the Finance and Capital Market Commission Guidelines as at 31 December 2009 has been set in the table below:

Description	31.12.2009 LVL
Tier 1	
- paid-in share capital	10,200,000
- audited retained earnings	4,266,983
- intangible assets	(461,740)
Total Tier 1	<u>14,005,243</u>
Capital base	<u><u>14,005,243</u></u>
Total capital requirements for credit and counterparty credit risks	5,705,629
- standardised approach (SA)	5,705,629
Total capital requirement for position and foreign exchange risks	586,234
Total capital requirements for operational risk	620,416
– basic index approach	620,416
Surplus of own funds	<u><u>7,092,964</u></u>
Capital adequacy ratio (%) (<i>[Capital base]: [Surplus of own funds] x 8%</i>)	<u><u>16.21%</u></u>

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NOTE 25 CURRENCY ANALYSIS

The following table provides the analysis of the Bank's assets, liabilities and shareholders' equity as well as off-balance sheet items outstanding as at 31 December 2009 by currency profile:

	USD LVL	EUR LVL	LVL LVL	Other currencies LVL	Total LVL
<u>Assets</u>					
Cash and deposits with the Bank of Latvia	265,131	303,201	6,076,700	20,172	6,665,204
Balances due from banks	28,183,584	11,197,099	14,513	870,067	40,265,263
Loans and advances to customers	42,422,844	24,544,095	613,382	37,761	67,618,082
Financial assets at fair value through profit or loss	1,032,302	792,694	6,486,996	1,858,696	10,170,688
Intangible assets	-	5,450	456,290	-	461,740
Property and equipment	-	3,484	473,915	911	478,310
Other assets	95,828	138,908	353,879	13,662	602,277
<u>Total assets</u>	71,999,689	36,984,931	14,475,675	2,801,269	126,261,564
<u>Liabilities and equity</u>					
Balances due to banks	245,498	1,424,350	12,440	-	1,682,288
Due to customers	72,490,013	34,822,405	1,088,618	832,449	109,233,485
Other liabilities	289,925	56,207	412,671	10,182	768,985
Derivative financial instruments	-	-	43,501	-	43,501
Deferred income tax liability	-	-	12,769	-	12,769
Equity	-	-	14,520,536	-	14,520,536
<u>Total liabilities and equity</u>	73,025,436	36,302,962	16,090,535	842,631	126,261,564
<i>Net long / (short) position on balance sheet</i>	(1,025,747)	681,969	(1,614,860)	1,958,638	-
<u>Off-balance sheet claims arising from foreign exchange</u>					
Spot foreign exchange receivable	1,448,572	211,544	-	-	1,660,116
Forward foreign exchange receivable	(220,273)	(841,610)	-	(610,000)	(1,671,883)
<i>Net long / (short) position on foreign exchange</i>	1,228,299	(630,066)	-	(610,000)	(11,767)
<i>Net long / (short) position</i>	202,552	51,903	(1,614,860)	1,348,638	(11,767)
As at 31 December 2008					
<u>Total assets</u>	13,192,376	64,898,376	32,912,532	260,594	111,263,878
<u>Total liabilities and shareholders' equity</u>	22,224,139	55,760,101	32,509,467	770,171	111,263,878
<i>Net long / (short) position on balance sheet</i>	(9,031,763)	9,138,275	403,065	(509,577)	-

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NOTE 26 LIQUIDITY RISK AND ANALYSIS OF ASSETS AND LIABILITIES BY MATURITY PROFILE

The table below allocates the Bank's assets and liabilities to maturity groupings as at 31 December 2009 based on the time remaining from the balance sheet date to the contractual maturity dates.

	Overdue	Within 1 month	1 – 3 months	3 – 6 months	6 – 12 months	1–5 years	Over 5 years and undated	Total
	LVL	LVL	LVL	LVL	LVL	LVL	LVL	LVL
Assets								
Cash and balances with the Bank of Latvia	-	6,665,204	-	-	-	-	-	6,665,204
Balances due from banks	-	28,453,522	8,779,423	2,706,098	296,880	29,340	-	40,265,263
Loans and advances to customers	3,467,371	7,757,871	2,955,518	11,683,429	22,849,384	16,819,275	2,085,234	67,618,082
Financial assets at fair value through profit or loss	-	8,280,224	-	-	-	-	1,858,696	10,138,920
Intangible assets	-	-	-	-	-	461,740	-	461,740
Property and equipment	-	-	-	-	-	-	478,310	478,310
Derivative financial instruments	-	30,526	1,242	-	-	-	-	31,768
Deferred expenses	-	-	-	-	98,539	-	-	98,539
Income tax	-	-	300,846	-	-	-	-	300,846
Other assets	-	202,892	-	-	-	-	-	202,892
Total assets	3,467,371	51,390,239	12,037,029	14,389,527	23,244,803	17,310,355	4,422,240	126,261,564
Liabilities and equity								
Balances due to banks	-	257,938	-	-	1,424,349	-	-	1,682,287
Due to customers	-	76,375,101	12,087,407	4,311,491	7,893,093	8,566,394	-	109,233,486
Derivative financial instruments	-	43,432	69	-	-	-	-	43,501
Deferred income and accrued expenses	-	-	-	-	503,558	-	-	503,558
Other liabilities	-	265,427	-	-	-	-	-	265,427
Deferred income tax liability	-	-	-	-	12,769	-	-	12,769
Equity	-	-	-	-	-	-	14,520,536	14,520,536
Total liabilities and equity	-	76,941,898	12,087,476	4,311,491	9,833,769	8,566,394	14,520,536	126,261,564
Net liquidity	3,467,371	(25,551,659)	(50,447)	10,078,036	13,411,034	8,743,961	(10,098,296)	-
As at 31 December 2008								
Total assets	2,670,834	37,119,847	6,214,737	24,562,222	18,850,353	19,077,505	2,768,380	111,263,878
Total liabilities and equity	-	60,717,589	9,574,455	18,061,804	6,611,059	1,831,988	14,466,983	111,263,878
Net liquidity	2,670,834	(23,597,742)	(3,359,718)	6,500,418	12,239,294	17,245,517	(11,698,603)	-

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NOTE 26 LIQUIDITY RISK AND ANALYSIS OF ASSETS AND LIABILITIES BY MATURITY PROFILE (continued)

The table below allocates the Bank's financial liabilities on undiscounted cash flow bases as at 31 December 2009:

	Overdue	Within 1 month	1 – 3 months	3 – 6 months	6 –12 months	1–5 years	Over 5 years and undated	Total
	LVL	LVL	LVL	LVL	LVL	LVL	LVL	LVL
Balances due to banks	-	264,498	18,741	28,112	1,443,090	-	-	1,754,441
Due to customers	-	76,530,922	12,353,162	4,719,914	8,672,834	8,940,361	-	111,217,193
Other liabilities	-	308,859	69	-	509,660	-	-	818,588
Total liabilities	-	77,104,279	12,371,972	4,748,026	10,625,584	8,940,361	-	113,790,222

The table below allocates the Bank's financial liabilities on undiscounted cash flow bases as at 31 December 2008:

	Overdue	Within 1 month	1 – 3 months	3 – 6 months	6 –12 months	1–5 years	Over 5 years and undated	Total
	LVL	LVL	LVL	LVL	LVL	LVL	LVL	LVL
Balances due to banks	-	7,903,833	-	-	-	-	-	7,903,833
Due to customers	-	52,511,124	9,514,527	18,188,229	6,393,590	2,020,388	-	88,627,858
Other liabilities	-	227,758	87,362	-	438,317	-	-	753,437
Total liabilities	-	60,642,715	9,601,889	18,188,229	6,831,907	2,020,388	-	97,285,128

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NOTE 27 RE-PRICING MATURITY OF ASSETS AND LIABILITIES

The table below allocates the Bank's assets and liabilities to maturity groupings as at 31 December 2009 based on the time remaining from the balance sheet date to the earlier of maturity and contractual re-pricing dates.

	Within 1 month	1-3 months	3-6 months	6-12 months	1-5 years	Over 5 years	Positions which are not sensitive to the interest rate risk	Total
	LVL	LVL	LVL	LVL	LVL	LVL	LVL	LVL
Assets								
Cash and balances with the Bank of Latvia	-	-	-	-	-	-	6,663,988	6,663,988
Balances due from banks	23,760,449	-	-	-	-	-	16,130,948	39,891,397
Loans and advances to customers	10,927,337	8,928,666	14,804,861	20,724,745	11,643,196	448	-	67,029,253
Financial assets at fair value through profit or loss	-	2,918,646	2,610,015	826,118	1,925,445	-	1,858,696	10,138,920
Intangible assets	-	-	-	-	-	-	461,740	461,740
Property and equipment	-	-	-	-	-	-	478,310	478,310
Other assets	-	-	-	-	-	-	1,597,956	1,597,956
Total assets	34,687,786	11,847,312	17,414,876	21,550,863	13,568,641	448	27,191,638	126,261,564
Liabilities								
Balances due to banks	12,440	-	-	1,405,608	-	-	-	1,418,048
Due to customers	33,588,701	3,280,091	1,663,896	7,518,303	8,534,866	-	54,273,254	108,859,111
Other liabilities	-	-	-	-	-	-	1,451,100	1,451,100
Deferred income tax liability	-	-	-	-	-	-	12,769	12,769
Total liabilities	33,601,141	3,280,091	1,663,896	8,923,911	8,534,866	-	55,737,123	111,741,028
Equity	-	-	-	-	-	-	14,520,536	14,520,536
Total liabilities and equity	33,601,141	3,280,091	1,663,896	8,923,911	8,534,866	-	70,257,659	126,261,564
<i>On balance sheet interest sensitivity analysis</i>	1,086,645	8,567,221	15,750,980	12,626,952	5,033,775	448	(43,066,021)	-
As at 31 December 2008								
Total assets	11,385,769	11,882,825	14,953,384	17,843,968	14,096,104	61,251	41,040,577	111,263,878
Total liabilities and equity	5,823,037	7,062,106	9,028,151	6,100,561	1,821,767	-	81,428,256	111,263,878
<i>On balance sheet interest sensitivity analysis</i>	5,562,732	4,820,719	5,925,233	11,743,407	12,274,337	61,251	(40,387,679)	-

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NOTE 28 RELATED PARTY TRANSACTIONS

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

Related parties are defined as shareholders, members of the Council and the Board, key management personnel, their close relatives and companies in which they have a controlling interest as well as associated companies.

The balances in respect of operations with related parties are as follows as at 31 December 2009:

	Other related parties
Undrawn credit lines	<u>22,277</u>

Total amounts of loan commitments issued to and repaid by related parties during 2009 are as follows:

	Shareholders with significant control	Enterprises under the control of beneficiaries	Other related parties
Issued to related parties	3,674,339,323	-	3,977
Repaid by related parties	3,678,665,207	38,880	11,258

Operations with the related parties were as follows as at December 2009:

	Shareholders with significant control	Enterprises under the control of beneficiaries	Other related parties
Total loans and advances (interest rate on agreement: 5.5 - 18%)	16,227,628	903,018	17,196
Investment securities for trading purposes	427,838	-	-
Correspondent account	33,369	-	-
Due to customers (interest rate: 6.25 – 7.7%)	-	55,764	84,738
Vostro account	12,440	-	-

Income and expense from operations with related parties during 2009 were as follows:

	Shareholders with significant control	Enterprises under the control of beneficiaries	Other related parties
Interest income	2,520,067	62,221	1,337
Interest expenses	26,162	-	1,963
Fee and commission income	-	-	949
Fee and commission expense	7,979	-	-
Profit from revaluation of financial instruments with revaluation through profit and loss	199,848	-	-
Administrative and other operating expenses	7,599	-	-

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NOTE 28 RELATED PARTY TRANSACTIONS (continued)

The balances in respect of operations with related parties are as follows as at 31 December 2008:

	Other related parties
Undrawn credit lines	<u><u>15,094</u></u>

Total amounts of loan commitments issued to and repaid by related parties during 2008 are as follows:

	Shareholders with significant control	Enterprises under the control of beneficiaries	Other related parties
Issued to related parties	1,777,475,716	105,421	6,374
Repaid by related parties	<u>1,757,856,427</u>	<u>792,000</u>	<u>392</u>

Operations with the related parties were as follows as at December 2008:

	Shareholders with significant control	Other shareholders	Enterprises under the control of beneficiaries	Other related parties
Total loans and advances (interest rate on agreement: 6 - 18%)	20,943,083	-	917,276	24,477
Investment securities for trading purposes	229,908	-	-	-
Correspondent account	4,551,164	-	-	-
Due to customers (interest rate: 5.25 – 8.6%)	-	108	-	29,320
Vostro account	12,440	-	-	-
Interbank deposits	<u>1,811,945</u>	<u>-</u>	<u>-</u>	<u>-</u>

Income and expense from operations with related parties during 2008 were as follows:

	Shareholders with significant control	Other shareholders	Enterprises under the control of beneficiaries	Other related parties
Interest income	868,381	50	136,591	1,448
Interest expenses	91,329	2,430	7	37,881
Fee and commission income	-	1,136	168	927
Fee and commission expense	16,275	-	-	-
Administrative and other operating expenses	<u>5,832</u>	<u>-</u>	<u>-</u>	<u>-</u>

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NOTE 28 RELATED PARTY TRANSACTIONS (continued)

Remuneration to key management is disclosed below:

	2009	2008
	LVL	LVL
<i>Short-term benefits:</i>		
- Salaries	258,565	234,959
- Short-term bonuses	-	20,513
<i>Pension benefits:</i>		
- Expenses to the State Pension Insurance	61,066	36,979
Total	<u>319,631</u>	<u>292,451</u>

NOTE 29 FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

In respect of financial assets and liabilities held in the balance sheet at carrying values other than fair value, in the opinion of Management the fair value of those financial assets and liabilities differ from their carrying values, as follows:

	2009		2008	
	Book value	Fair value	Book value	Fair value
	LVL	LVL	LVL	LVL
<u>Assets</u>				
Loans to customers	<u>67,618,082</u>	<u>73,555,014</u>	<u>65,252,570</u>	<u>70,631,825</u>

Interest rates used to determine fair value are equal with the interest rates set in the loan agreements where variable part of the interest rate is calculated based on the interbank market (EURIBOR, LIBOR, etc.) rates implicit at the year end.

NOTE 30 TAXES

	Balance	Calculated in	Paid in 2009	Balance
	31.12.2008	2009		31.12.2009
	LVL	LVL	LVL	LVL
Corporate income tax*	(172)	257,918	558,592	(300,846)
State compulsory social insurance contributions	-	482,289	444,369	37,920
Personal income tax	-	319,366	320,229	(863)
Value added tax	5,288	52,285	50,936	6,637
(Overpaid)	<u>(172)</u>			<u>(301,709)</u>
Liabilities	<u>5,288</u>			<u>44,557</u>

* CIT calculated and paid is reduced by the amount of tax paid abroad – LVL 257,267.

The tax authorities have the right to inspect the tax computations for the last three taxation years. State revenue service carried out corporate income tax and value added tax review in 2008 for the year 2005 and 2006. No critical findings were identified. The Company's management is not aware of any circumstances which may give rise to a potential material liability in this respect.

NOTE 31 SUBSEQUENT EVENTS

There are no subsequent events since the last date of the reporting year, which would have a significant effect on the financial position of the Company as at 31 December 2009.